JAPAN

Japan ran a global current account surplus of $121 billion in 1998, a 39 percent increase over 1997, and its global trade surplus rose to $108 billion, a 31-percent increase over 1997 levels. Japan is facing its worst recession since the end of World War II and, as its demand for imports declines and its firms redouble their efforts to sell to healthier markets abroad, the effects of Japan's economic policies will continue to hit the United States. In 1998, the U.S. goods trade deficit with Japan reached $64.1 billion, an increase of $8.4 billion (14.2 percent) from the 1997 level of $55.7 billion. While Japan was the United States' third largest export market in 1998, U.S. merchandise exports to Japan fell to $57.9 billion, a decrease of 11.9 percent from the 1997 level. Although import surges were evident in certain sectors, particularly steel, U.S. imports from Japan rose only 0.5 percent in 1998 (to $122 billion from $121.7 billion in 1997). Japan is more dependent on the U.S. market to absorb its exports than it has been for many years. In 1998, the United States bought about 31 percent of Japan's exports, the highest level since 1990, and close to the all-time high of 36 percent in 1986.

Overview

The United States attaches top priority to opening Japan's markets to U.S. goods and services. Toward this end, the Clinton Administration has continued to emphasize the need for implementation of fiscal stimulus and reform of Japan's financial sector, as well as comprehensive deregulation and market-opening measures to reverse Japan's recession and stimulate sustained economic growth over the medium to long-term.

To open Japan's market, the United States has pursued a multi-faceted approach which has centered upon: (1) encouraging major structural reform and deregulation to open more sectors of Japan's economy to competition; (2) negotiating new trade agreements; (3) monitoring and enforcing existing trade agreements covering key sectors, including autos and auto parts, flat glass, insurance, and government procurement; and (4) addressing concerns through regional and multilateral fora.

Our comprehensive approach to the economic relationship with Japan was first outlined in the United States-Japan Framework for a New Economic Partnership ("Framework Agreement"), signed by President Clinton and then-Prime Minister Miyazawa in July 1993. Under this agreement, the United States and Japan agreed to focus on eliminating sector-specific market access barriers and addressing structural and macroeconomic obstacles. While Japan has reduced its formal tariff rates on imports to very low levels, it maintains a wide range of other market access barriers including non-transparent, discriminatory standards, exclusionary business practices, and a business environment that protects domestic companies and restricts the free flow of competitive foreign goods into its market. An important innovation of the Framework Agreement was its emphasis on objective quantitative and qualitative criteria for monitoring the agreements, which allow the governments to more accurately assess progress under the agreements.

Since 1993, the United States has concluded 35 trade agreements with Japan, covering a wide variety of sectors from autos and auto parts, insurance, civil aviation and harbor practices, to agricultural products, entertainment and high technology. These agreements also address broad structural issues, such as distribution and investment. In each case, the agreements offer new opportunities to U.S. exporters and to others with competitive products and services to offer, as well as to Japanese producers and consumers.

Building on the Framework Agreement, President Clinton and then-Prime Minister Hashimoto initiated in June 1997 the Enhanced Initiative on Deregulation and Competition Policy ("Enhanced Initiative"), which has become the main vehicle for bilateral efforts to promote comprehensive deregulation and strengthen Antimonopoly Law enforcement. The first year of the Enhanced Initiative generated meaningful results in

a wide range of sectors. Japan agreed to implement concrete deregulatory measures in each of the sectors covered under the Enhanced Initiative and to include energy as a new sector. Japan also agreed to implement specific measures designed to address structural concerns relating to competition policy, distribution, transparency, and other government practices.

During 1998, the United States pressed Japan to fully implement these deregulatory measures and in October provided Japan with more than 200 proposals aimed at further deregulation of the Japanese economy. The United States is seeking agreement on a new set of deregulatory measures which Japan will implement by Spring 1999.

In January 1998, the United States concluded a Civil Aviation Agreement with Japan. This agreement is aimed at significantly liberalizing the civil aviation market between the United States and Japan, including for both U.S. passenger and cargo carriers, and is expected to increase U.S. aviation service-related exports by $1 billion annually.

In May 1998, President Clinton and then-Prime Minister Hashimoto announced the "U.S.-Japan Joint Statement on Electronic Commerce," which expressed the two nations' agreement that the private sector take the lead in developing the Internet, with government regulation kept to a minimum. It also noted, among other things, that both countries would work in the WTO to see that electronic transmissions on the Internet are kept tariff-free.

The Administration also continued to focus attention in 1998 on the monitoring and enforcement of existing agreements to ensure their complete and successful implementation. The United States pressed Japan to make progress on our bilateral agreements including those covering autos and auto parts; insurance; flat glass; construction; semiconductors; medical devices and pharmaceuticals; and government procurement of computers and of supercomputers. In several areas, such as automotive and flat glass, the United States offered new proposals for generating progress, while proposing ways to update other agreements, such as computers and supercomputers, to make them more effective. The United States hopes to reach agreement with Japan on these proposals in the immediate future.

The United States has also continued to invoke the WTO Dispute Settlement Mechanism to address problems related to market access barriers in Japan. In October, a WTO dispute panel ruled in favor of the United States in its case against Japan regarding its unfairly burdensome and non-transparent requirements on varietal testing of fruits exported to Japan, finding that those requirements have no scientific basis. Both parties appealed the decision and, in February 1999, the WTO Appellate Body upheld the panel's findings in favor of the United States.

In addition, the Administration continued to press Japan for meaningful access to its photographic film and paper sector through its market-opening initiative announced in February 1998. The U.S. Government released its first semi-annual film monitoring report in August reviewing Japan's implementation of formal representations it made to the WTO regarding the openness of its photographic film and paper market. The report called on Japan to take additional action to open its photographic film and paper market and to ensure the elimination of practices that unreasonably restrict competition in this sector, despite the improvements in market access seen in some segments of the market in the past three years. The Administration plans to issue its next monitoring report in the Spring, 1999.

The United States also sought Japan's cooperation through the Asia-Pacific Economic Cooperation Forum (APEC) to open trade in specific sectors. The APEC members, including Japan, agreed in Kuala Lumpur in November 1998 to build consensus on the sector liberalization initiative begun in the APEC forum. Japan agreed to work constructively in the WTO to reach agreement on accelerated tariff reductions in eight sectors

in 1999 including chemicals, energy equipment and services, environmental goods and services, fish and fishery products, gems and jewelry, medical and scientific instruments, toys and fish products. Such a significant package of tariff reductions will send a valuable message of confidence to markets at a critical time and meaningful participation by Japan, particularly in the fishery and forestry products sectors, will be essential to success. Finally, the United States will continue to seek further opening of the Japanese market through ongoing WTO negotiations, as well as upcoming trade negotiations.

U.S.-Japan Enhanced Initiative: Japan and Deregulation

Japan's recent government deregulation efforts notwithstanding, the Japanese economy remains burdened by excessive and unneeded regulations. Japanese economists estimate that the Japanese Government regulates about 40 percent of all economic activity in Japan. Excessive over-regulation in Japan in areas such as price controls, burdensome testing and certification requirements and unconventional standards restrain economic growth and raise the cost of doing business in Japan, lower the standard of living for Japanese consumers, and impede imports. The Japanese Government estimates that if its deregulation plans are fully implemented, Japan's GDP would grow by an added 0.9 percent annually during the JFY 1998-2003 time period, while the ratio of Japan's current account surplus to its GDP would decline by 0.9 percent.

Government over-regulation lies at the heart of many market access problems faced by U.S. companies doing business in Japan. Some regulations are aimed squarely at imports; others are part of a system, which protects the status quo against new market entrants, both foreign and Japanese. The United States has aggressively pushed for the elimination of regulations that impede market access for U.S. firms, and many recent U.S.-Japan trade agreements have addressed issues related to the regulation of Japan's markets.

Since 1995, the Japanese Government has undertaken a series of deregulatory measures, the latest being a three-year program for the promotion of deregulation decided by the Cabinet on March 31, 1998, which will continue through March 2001. To encourage Japan to adopt meaningful commitments to deregulate, the United States and other trading partners have provided Japan with annual submissions that describe specific deregulation recommendations. To date, progress under the deregulation plans has been modest.

In February 1998, the Hashimoto Government established a 12-person Deregulation Committee. This committee, which compiled the second Deregulation Action Plan, oversees implementation of the measures contained in that Plan. The Deregulation Committee is subordinate to the Japanese Government's Administrative Reform Promotion Headquarters, chaired by Prime Minister Obuchi. While the life span of the Deregulation Committee has not yet been defined, it is expected to continue through the duration of the Second Deregulation Action Plan. Because the powers of the Deregulation Committee are limited, (e.g., the Committee does not have the authority to compel Japanese ministries and agencies to adopt its recommendations), the United States has urged that a new and stronger entity be created within the Prime Minister's Office which could compel regulatory ministries and agencies in Japan to implement new deregulation measures and monitor those measures already announced.

The Enhanced Initiative on Deregulation and Competition Policy

To promote the goals of the Framework Agreement, accelerate the pace of deregulation in Japan, and increase market access for foreign goods and services, on June 19, 1997, President Clinton and then- Prime Minister Hashimoto established the Enhanced Initiative on Deregulation and Competition Policy ("Enhanced Initiative"). The Enhanced Initiative addresses sectoral and structural issues, and seeks the reform of government laws, administrative guidance, and regulations which impede market access for competitive foreign goods and services. Under the aegis of the Enhanced Initiative, six expert-level groups have conducted several rounds of meetings: five sectoral groups covering telecommunications, housing, medical

devices and pharmaceutical products, financial services, and energy; and one group addressing various structural issues, including competition policy legal services, distribution, and transparency and other government practices.

During the Enhanced Initiative's first year, significant progress was made in breaking down a number of Japan's regulatory barriers. In the First Joint Status Report under the Enhanced Initiative issued in Birmingham, England in May 1998 ("First Joint Status Report"), Japan agreed to a number of important regulatory reform measures, including decisions to:

- implement a long-run incremental cost methodology (LRIC) to reduce the interconnection rates that telecommunications carriers must pay to connect to Japan's local telecommunications network;

- cut the approval period for new drugs from 18 months to 12 months by April 2000, and to greatly expand the acceptance of foreign clinical data in its approval of new medical devices and pharmaceuticals;

- enact several financial services-related measures under the "Big Bang" initiative, including the liberalization of derivatives trading, easing the registration process for new securities companies, and a sharp expansion in the scope of financial activities and products that banks and securities companies can undertake;

- abolish the Large Scale Retail Store Law and introduce a new legal regime that eliminates the use of supply/demand adjustment mechanisms;

- introduce legislation to abolish or reform the exemption systems for the Antimonopoly Act; and

- simplify and accelerate the application process for licenses and permits needed to do business in Japan.

In October 1998, the United States provided the Japanese Government its "Submission by the Government of the United States to the Government of Japan regarding Deregulation, Competition Policy, and Transparency and other Government Practices in Japan." This was a detailed description of deregulation measures the United States is seeking in all of the sectoral and structural areas during the second year of the Enhanced Initiative.

Senior-level meetings to discuss the Enhanced Initiative's work during its second year were chaired by the Deputy U.S. Trade Representative and Japan's Deputy Foreign Minister in November 1998 in Washington and in March 1999 in Tokyo. Both Governments aim to issue a Second Joint Status Report of substantive new market-opening measures to deregulate Japan's economy in the Spring of 1999.

SECTORAL DEREGULATION

Telecommunications

Under the Enhanced Initiative, the United States seeks regulatory changes to promote competition in the telecommunications sector. This sector has long been encumbered by excessive, outdated regulations and controlled by two dominant carriers, (*Nippon* Telegraph and Telephone Corporation (NTT), and *Kokusai Denshin Denwa* (KDD)), that exercise market power to deter the entry and development of new competitors. Both the United States' 1997 and 1998 submissions target excessive regulations and inadequate safeguards against anti-competitive activities in basic telecommunications, direct-to-home (DTH) satellite service,

wireless equipment, cable television, and power main signaling. The United States has focused particular attention on those areas where U.S. firms have demonstrated strengths and where existing and potential investment stand to bring much-needed growth to this sector through innovative, competitively priced services. Since the Japanese telecommunications and broadcasting services market is worth an estimated $128 billion per year (and has the potential to expand significantly), a more open and accessible Japanese telecommunications market translates into increased opportunities for U.S. service and equipment exporters.

In recognition of a number of significant improvements identified in the First Joint Status Report, Japan has made some progress in addressing several areas of concern to the United States. Notably, Japan agreed to (1) introduce a pro-competitive methodology for setting interconnection rates in 2000 and promote the reduction of interim interconnection rates; (2) allow direct-to-home satellite service providers to offer a significantly expanded number of channels; (3) liberalize rules to allow international telecommunications service providers to use leased lines to bypass the over-priced international settlement system and bring international rates in line with those of competitive markets; (4) eliminate the restrictions on foreign investment in its major international carrier, KDD; (5) remove the restrictions on using third parties for transit of international telecommunications traffic; (6) complete a study by the end of 1998 on rights-of-way with the aim of improving access to these scarce resources; (7) reduce fees and simplify procedures for testing and certifying wireless equipment; and (8) consider eliminating foreign investment restrictions in Cable TV businesses.

These actions and commitments, which the United States is continuing to monitor closely, should help address important market access issues. Nevertheless, ensuring credible competition, especially in the local telecommunications markets, will require Japan to demonstrate more firmly that it can act as an independent regulator more attuned to providing equitable opportunities to new entrants and less biased towards the financial interests of an operator still majority owned by the Japanese Government.

Japan's failure to take necessary steps to enhance competition has resulted in new entrants having to endure expensive and slow roll-outs of new networks. In providing local service, for example, new entrants must traverse a maze of obscure market practices and non-transparent regulations that inhibit access to all but the most patient, determined, and highly capitalized firms. These impediments ultimately serve to protect inefficient incumbents from effective competition, unnecessarily increase the cost of establishing such a network, thereby slowing the delivery of benefits to consumers.

On another front, interconnection rates, which total as much as five times the level of rates in competitive markets, also place enormous burdens on new market entrants. In addition, the inability to use transit arrangements (or a "clearinghouse") to reach the dozens operators in Japan means that new entrants must devote valuable resources to negotiating individual agreements with operators or forego offering connectivity to their customers. Further, the lack of effective rights-of-way rules raises costs, slows network build-out, and prevents new entrants and consumers from deriving the benefits of more efficient network architectures. Finally, MPT's refusal to permit new entrants to rely on leased capacity until they can build out their own networks clinches the incumbent's grip on new entrants' cost structures by forcing them to rely broadly on above-cost interconnection.

To address these and other concerns, the United States has urged Japan to (1) lower interconnection rates for FY 1998 below the level proposed by NTT; (2) establish regulations requiring transparent, non-discriminatory, timely and cost-based access to rights-of-way needed to construct telecommunications networks; (3) remove restrictions on carriers wishing to use leased or owned lines to operate their networks; (4) establish a system of dominant carrier regulation to effectively regulate carriers with market power while liberalizing rules for non-dominant carriers; (5) develop a fair system which allows customers to access different carriers' services; (6) eliminate the need to negotiate dozens of interconnection agreements before

service can begin; and (7) eliminate restrictions placed on the use of new technologies which employ power mains to transmit communications signals for a range of innovative automation and control services, which are widely employed in the United States and Europe.

Because several of these issues, notably interconnection costing and the use of leased capacity, relate to Japan's WTO commitments, failure to adequately address these issues raises concerns.

Medical Devices and Pharmaceutical Products

Under the 1986 Market-Oriented, Sector-Selective (MOSS) Medical and Pharmaceutical agreement, the U.S. Department of Commerce (DOC) and Japan's Ministry of Health and Welfare (MHW) co-chair a process which addresses regulatory and market access concerns. The MOSS Med/Pharm working group now also serves as the venue for discussion of medical and pharmaceutical issues under the Enhanced Initiative. As Japan undertakes potentially extensive health care reforms, price reimbursement and regulatory issues remain the focus of bilateral consultations. The United States and Japan held consultations on Japanese deregulation of medical devices and pharmaceutical products in March and October 1998 and in January 1999. Each of these consultations addressed Japan's implementation of its undertakings under the Enhanced Initiative, as well as additional measures designed to improve Japan's regulatory and reimbursement structures.

With regard to regulatory reform, the United States remains concerned that Japan's approval processes for medical devices and pharmaceuticals lag behind those of other industrialized countries. Such delays impose unnecessary cost burdens on both U.S. manufacturers and the Japanese health care system. Under the Enhanced Initiative, Japan has agreed to expedite its regulatory approval for new drugs by reducing the application review process from 18 months to 12 months by April 2000. This measure will allow the introduction of new medicines in Japan on a more timely basis, a benefit to both Japanese consumers and U.S. manufacturers alike. The United States is closely monitoring Japan's implementation of this undertaking and is pressing Japan to take specific interim measures to improve the new drug application approval process. In addition, the United States is pursuing improvements in the medical device approval system.

Japan's longstanding practice of limiting the acceptance of foreign clinical data for pharmaceutical and medical device approvals imposes unnecessary and unwarranted time and resource burdens on U.S. firms by requiring them to conduct duplicative clinical trials in Japan. Under the Enhanced Initiative, Japan has agreed to greatly expand the acceptance of foreign clinical data in the approval of new medical devices and pharmaceuticals. This Japanese measure will significantly reduce the time and expense U.S. firms must devote to new product testing and approval. The United States welcomes Japan's August 1998 adoption of International Conference on Harmonization Guidelines and is monitoring the implementation of this undertaking. The United States is also pursuing additional measures designed to broaden Japan's acceptance of foreign clinical data in the reimbursement process for medical devices to prevent delays that are caused by calls for domestic data.

In addition to regulatory barriers, the United States is addressing specific trade issues associated with Japan's current reimbursement system and longstanding practice of revising prices for medical devices and pharmaceuticals. The United States is concerned that Japan's reimbursement system lacks full transparency. Under Japan's national health care insurance system, reimbursement prices for drugs and devices do not always appropriately reward the true benefits of innovative products, and prices are frequently determined and revised based on a non-transparent, seemingly arbitrary basis.

Most U.S. manufactured medical devices on the Japanese market fall under the "by-function" pricing system, which assigns a newly introduced product to a reimbursement category of like products and prices it as other

products already on the market. Under this system however improved medical devices that offer superior abilities and functions are often subject to artificially low reimbursement prices due to the fact that reimbursements are calculated according to outdated and/or inaccurate "by-function" categories. Under the Enhanced Initiative, Japan has agreed to work with industry to develop, as soon as possible, streamlined and transparent procedures for the creation of new functional categories. Although progress has been slow, the United States continues to press Japan to ensure that other changes in the by-function system do not take place before the adoption of guidelines to create new categories occurs.

In formulating its health care reforms, Japan has agreed to formally recognize the value of innovation, so that innovative products can be introduced promptly in Japan. Pursuant to this undertaking, the United States has urged Japan to adopt a market-based pricing system for pharmaceuticals that will not impede or prevent the introduction of innovative pharmaceuticals in Japan. The United States strongly opposes Japan's reference pricing proposal because such a system threatens drug innovation worldwide and prevents the introduction of innovative drugs in Japan, negatively affecting Japan's health care system and patient welfare.

Lack of access to decision-making processes and lack of transparency in the way that decisions are made have been longstanding problems in Japan that cut across all economic sectors; the medical device and pharmaceutical sectors are not exceptions. Under the Enhanced Initiative, Japan has agreed to ensure transparency in the consideration of health care policies by allowing foreign pharmaceutical and medical device manufacturers meaningful opportunities to state their opinions in the relevant councils on an equal basis with Japanese manufacturers. Japan has also agreed to provide foreign pharmaceutical and medical device manufacturers, upon their request, with opportunities to exchange views with MHW officials at all levels. The United States is monitoring the implementation of this undertaking and is encouraging Japan to carefully consider input provided by U.S. industry and to incorporate such input into Japan's final plans.

Lastly, the United States has been pressing Japan to address the structural problems underlying Japan's health care system, such as lack of volume buying and inadequate hospital specialization, that prevent efficient care delivery, substantially increase costs, and impede the timely introduction of new, innovative, and life-saving medical devices and pharmaceuticals. The United States continues to stress that cutting costs and improving the health care system in Japan will require the elimination of inefficiencies as well as the increased accessability and use of competitive foreign medical and pharmaceutical products.

Housing

Under the Enhanced Initiative, the United States and Japan established a Housing Experts Group. Consistent with the 1990 U.S.-Japan Wood Products agreement, the group promotes improved market access in Japan for foreign suppliers of wood and building products. At the same time, its work supports the objectives of several Japanese Government initiatives, including the March 1996 Deregulation Action Program, which envisages a one-third reduction in Japan's housing costs by the year 2000, and Prime Minister Obuchi's Living Space Initiative, which seeks to bring the living space of the average Japanese citizen up to European levels. Improved market access for wood and other building products and reliance on performance-based standards will lead to increased opportunities for American exporters as well as higher quality, safer, and more affordable housing in Japan.

The Housing Experts Group met twice in 1998 and again in February 1999. Its efforts have led to several significant changes, including: the development of a performance-based standard for 2x4 construction, as well as testing methods and procedures for implementation; recognition of U.S. grademarked-lumber for use in 2x4 construction in Japan; the lifting of the ban on construction of three-story, multi-family wood-frame housing; and reform of the Building Standards Law (BSL) so that it emphasizes performance-based, rather

than prescriptive, standards. Before the downturn in the housing market, U.S. industry had estimated that these changes could expand the market for U.S. wood products in Japan by $500 million annually by the end of the decade. Unfortunately, progress on implementation has been slow, but the United States continues to monitor the sector to ensure that Japan abides by its commitments.

Another long-standing U.S. objective in Japan has been the elimination of tariffs on value-added wood products. At the November 1998 APEC Summit, APEC economies, including Japan, agreed to:
(1) participate in WTO negotiations on the tariff elements of the sectoral initiatives developed by APEC, including forest products (which covers wood, paper, printed materials and wood furniture); and (2) seek conclusion of a WTO Agreement in 1999, which would lead to the phase-out of tariffs for wood products by 2004.

Financial Services

In an effort to address barriers to foreign financial services providers in Japan, the United States and Japan concluded a comprehensive financial services agreement, "Measures by the Government of Japan and the Government of the United States Regarding Financial Services," in February 1995. This agreement features an extensive package of market-opening actions in the key areas of asset management, corporate securities, and cross-boarder financial transactions. Since the agreement was signed, Japan has implemented the vast majority of the commitments made within specified time frames and in some instances, Japan has accelerated the timetable for implementation.

Building on the progress from the 1995 Agreement, in November 1996 then-Prime Minister Hashimoto announced the “Big Bang” initiative to carry out broad-based deregulation of Japan's financial sector, in order to make Tokyo's financial markets comparable to those of New York and London by 2001. This financial reform plan involves major changes, such as allowing mutual entry across financial sectors; liberalization of brokerage commissions and foreign exchange transactions; tightened disclosure rules; and further liberalization of asset management regulations. Despite increased concern about financial sector stability in Japan in late 1997 following several prominent financial bankruptcies, the Japanese Government has thus far adhered to its reform schedule, with few exceptions.

In April 1998, a new Foreign Exchange Law went into effect which greatly facilitates access to foreign exchange and allows a much broader range of participants (in addition to banks) to conduct foreign exchange business. Further, in December 1998, a comprehensive omnibus law took effect that revised 22 laws to reform Japan’s securities, banking, asset management, and insurance markets, as well as accounting and disclosure standards. Main features of the legislation include changing from a licensing to a registration system for new securities companies, expanding the market for investment trusts by allowing sales through banks and other changes, and introducing several new securities products, such as over-the-counter equity derivatives.

The past few years have seen changes in the Japanese financial sector. The traditional segmentation which exists among various types of financial institutions is gradually being phased out, and many features of market over-regulation are being addressed. These changes have resulted in expanded opportunities for foreign financial firms in Japan. Despite this progress, however, a number of concerns remain. Although the Ministry of Finance formally eliminated the use of administrative guidance in June 1998, the lack of transparency in rule making continues to be a problem. Other restrictions hindering the emergence of a fully competitive market for financial services in Japan include inadequate disclosure, the use of a positive list to define a security, and lengthy processing of applications for new products.

The United States Government is currently monitoring the 1995 agreement and Japan's progress under the "Big Bang" initiative to ensure that implementation remains on schedule. Japan also signed the WTO Financial Services Agreement in December 1997, thereby binding itself to many of the liberalization measures of the bilateral agreement.

Energy

The United States and Japan agreed to establish a working group on energy under the Enhanced Initiative in May 1998. The United States views these discussions as a means of providing input to Japan's efforts to deregulate this sector, which will lower energy costs and help strengthen the Japanese economy. The United States is also seeking to ensure that the manner in which Japan deregulates results in a more open, transparent and competitive automotive market and that Japan eliminates specific market access barriers in this sector.

During the first meeting of the Energy Working Group under the Enhanced Initiative held in October 1998, the United States presented proposals for addressing specific regulations that impede the sale of U.S. equipment and services in the Japanese energy sector, including: (1) regulations for approval and inspection of energy-related equipment under the Electric Utilities Industry Law and High Pressure Gas Law; (2) regulations for increasing the capacity of existing power generating facilities; (3) requirements for certification and approval of stand-by generator sets; and (4) regulations governing the manufacture and installation of self-service gasoline pumps.

The United States urged Japan to streamline these regulations and certifications procedures; pressed Japan to accelerate its efforts to adopt performance-based regulations through greater utilization of voluntary, private-sector standards, where appropriate; to accept international-recognized test data and certifications; and to take additional steps to enhance the transparency of its rulemaking and standards development processes. In addition, we strongly urged Japan to strengthen its competition policy advocacy and enforcement in this sector.

During the first Working Group meeting, the U.S. and Japan also discussed developments in electric utility deregulation in their markets. In January 1999, the U.S. Government provided comments to Japan on its proposed electric utility deregulation plan. To enhance Japan's competitiveness, the Japanese Government has sought to reform the electric power industry and introduce measures to reduce electric power rates -- the highest in the industrialized world -- to international levels by 2001. Throughout 1998, a special "Basic Policy Committee" of the Electric Utilities Industry Council (EUIC) – a private sector advisory group to the Agency for Natural Resources and Energy (ANRE), and MITI, its parent ministry – met to discuss how to further liberalize the Japanese power market. The committee issued its final report in December 1998, which called for "partial liberalization" of the power market, with retail sale of electricity to be liberalized for large-scale users served by extra-high voltage networks (of 20,000 volts or higher), which account for approximately 30 per cent of total electricity consumption in Japan. In its comments, the U.S. Government expressed its view that the EUIC proposals would make only modest progress towards Japan's goal of achieving a significant lower energy costs.

During the second meeting of the Energy Working Group held in February 1999, the two sides discussed U.S. proposals for eliminating regulatory barriers to the Japanese energy market. Japan agreed to take concrete steps to address many of the U.S. concerns regarding standards, inspection and certification requirements, and other regulations covering the import of specific types of energy-related equipment, including turbines, compressors, gasoline pumps, and stand-by generator sets. Japan also agreed to liberalize regulations governing the expansion of existing power generation facilities. These steps will help encourage new entrants

and additional investment in the Japanese energy sector and support Japan's efforts to lower energy prices. In

addition, the two sides exchanged views on Japanese Government plans for electricity sector deregulation, as well as the ongoing restructuring of this sector in the United States, and agreed to continue this dialogue as deregulation proceeds. The United States also raised concerns about Japan's antitrust exemption for the electricity sector and urged the Japanese Government to eliminate this exemption. The United States will continue to press Japan to deregulate and eliminate market access barriers in the energy sector.

STRUCTURAL DEREGULATION

Antimonopoly Law and Competition Policy

Under the Enhanced Initiative, the United States has recommended a number of progressive measures which it believes will strengthen competition policy and lead to more effective enforcement of Japan's Antimonopoly Law (AML). Despite the 1996 "upgrade" of the Japan Fair Trade Commission's (JFTC) organizational status, the United States continues to believe that further strengthening of AML enforcement and competition policy in Japan is critical to improving market access. Foreign companies continue to face numerous impediments in accessing Japan's distribution channels across a wide range of sectors, including the automotive, paper and paperboard, flat glass, and photographic film and paper markets. Since October 1998, the Administration has focused particular attention on achieving genuine progress in the following AML and competition policy-related issues under the Enhanced Initiative:

JFTC Competition Policy Advocacy: Successful regulatory reform in Japan must be built on a solid foundation of effective competition policy. As the only Japanese agency charged with promoting competition, the JFTC should substantially boost its efforts as an advocate of competition policy and regulatory reform by championing removal of competition-blunting regulations. To this end, the United States has asked Japan to take several steps to enhance the JFTC's competition policy advocacy, such as establishing a Competition Policy Bureau to act as a strong advocate of competition and regulatory reform; introducing a Competition Policy Advocacy Plan; establishing a model JFTC Antimonopoly Law Compliance Manual and Program, which would be widely distributed to Japan's business community; and enabling the JFTC Chairman to regularly attend cabinet meetings. The United States has also requested that the JFTC strengthen its monitoring of private sector regulations or "*minmin kisei*" that may be used by industry and trade associations to restrict competition or market entry. To further enable the JFTC to participate in the regulatory process, the United States has proposed that the JFTC more actively exercise its existing statutory authority to hold hearings and comment on important deregulatory and competition policy issues. The United States has also urged Japan to amend the AML to allow the JFTC to provide its views to central and local government organs and committees, and review and comment on any proposed regulation to assess the regulation's competitive effect.

Private Remedies: Under Japanese law, there is absolutely no right for an injured party to bring an injunction against an alleged violator of the AML. Regarding private actions for money damages, since 1947 only eleven private actions for damages have been brought under the AML – this is due, in part, to the fact that the JFTC must first issue a formal recommendation against a firm before a private party can bring an action against the same firm. The United States strongly believes that the unfettered availability of injunctive relief and money damages to private litigants is an integral part of a comprehensive antimonopoly legal regime. In short, persons directly injured by anticompetitive behavior should be able to avail themselves of the AML if they choose to do so. Moreover, private AML enforcement can help alert Japanese firms to the importance of conforming their business practices to the AML, which in turn will keep markets free, open and competitive. A study group established by the Ministry of International Trade and Industry (MITI) issued a report in June 1998 that guardedly favored allowing private parties to bring injunction actions. Shortly

thereafter, a JFTC advisory council began studying the question of private injunctive relief, as well as reform

of the current system of private damage actions. In December 1998, the JFTC advisory body recommended in an interim report that it would be "appropriate" to allow private parties to bring injunction actions. The same JFTC advisory body will issue a report in 1999 addressing the issue of private damage actions. The United States welcomes these initiatives by MITI and the JFTC and strongly urges Japan to enact legislation that will lift the current restrictions on private injunctive relief and private action damages.

Anticartel Enforcement: Bid-rigging and collusive cartel activity continue to be serious problems in Japan. The United States has called for more aggressive enforcement actions to combat these activities and has urged Japan to increase the investigatory burden sharing between the JFTC and the Public Prosecutors Office; strengthen resources at the Ministry of Justice for criminal antimonopoly investigations; and boost JFTC and Ministry of Justice cooperation in criminal antimonopoly enforcement. In addition, the United States has proposed that an advisory council be established to examine methods of strengthening the JFTC's investigatory powers. To better combat bid-rigging, the United States has suggested that all bidders on public projects certify through a Certificate of Independent Pricing Determination that bid prices have been arrived at independently without any consultation, communication, or agreement for the purpose of restricting competition with any other bidder. To stiffen deterrence of criminal antimonopoly activity, the United States has proposed that criminal penalties for AML violations be strengthened significantly.

Distribution: A longstanding United States concern has been that business practices in Japan's distribution system have limited access of foreign suppliers to a number of sectors, including retailing, paper and paperboard, and flat glass. The United States has proposed that the JFTC establish a Retail Sector Competition Promotion Initiative to ensure that the recently enacted Large-Scale Retail Store Location Law not be used by local or prefectural government to unfairly limit the entry of large-scale retailers. Moreover, the United States requested the JFTC to initiate a follow-up survey to its 1993 paper industry survey, and finish by April 1999 an ongoing follow-up survey of the flat glass market. More broadly, the United States has asked the JFTC to consider surveying the extent and form of financial inter-relationships linking manufacturers and distributors in highly oligopolistic industries.

Antimonopoly Law Exemptions: The United States has urged that numerous exemptions to the AML either be abolished or substantially narrowed in scope, particularly those exemptions related to Depression and Rationalization Cartels. On February 16, 1999, the Japanese Cabinet announced its intention to introduce legislation to the Diet which will eliminate the exemptions for Depression Cartels, Rationalization Cartels, and other exemptions. Under the Enhanced Initiative, in May 1998, Japan agreed to submit legislation by March 1999 to implement these changes. The United States has also proposed that the JFTC amend the Premiums and Misrepresentations Law and Business Reform Law to ensure full application of the AML to Fair Trade Councils and firms subject to these two statutes, respectively.

JFTC Staffing & Resources: The United States has consistently urged since the Structural Impediments Initiative that the JFTC's budget and staff should be increased to ensure that it is able to carry out its mandate. The duties of the JFTC are increasing rapidly. For example, the abolition of numerous AML exemptions and stepped up deregulation now requires the JFTC to police more business behavior. Recognizing the importance of directing more resources and manpower to the JFTC, in 1996 a top MITI official stated that, "After deregulation is initiated, human resources should be shifted from regulatory bodies to competition authorities." The United States has recommended that the JFTC staff be increased by 25 persons annually over the next five years, the JFTC's budget be increased by 5% annually over the next five years, and the JFTC be exempted from the Japanese Government's rule requiring government organs to submit zero-growth budgets. The United States has also sought assurances from the Japanese Government that the JFTC's independence will not be compromised when it becomes part of the Ministry of General Affairs in 2001.

DISTRIBUTION

Japan's highly regulated, inefficient distribution system is widely recognized as a significant trade and investment barrier. Through the Enhanced Initiative's Working Group on Structural Issues, the United States has focused on laws, regulations, and practices that contribute to the abnormally high costs of distribution in Japan, such as slow customs processing, over-regulation of the trucking and warehouse industries, and excessive regulatory restrictions in the retail sector. In its October 1998 Deregulation submission, the United States requested the implementation of significant deregulation measures to address key distribution problems faced by foreign firms.

Regulation of Large Scale Retail Stores: The Large-Scale Retail Store Law has long been an obstacle to foreign investors and exporters, with its limitations on the establishment, expansion and business operations of large stores in Japan, which are most likely to handle imported products. By impeding the business operations of large stores, the Law reduced productivity in merchandise retailing, raised costs, discouraged new domestic capital investment and diminished the selection and quality of goods and services. It also acted to the detriment of Japanese consumers.

On May 8, 1998, the Japanese Diet passed legislation to abolish the Large-Scale Retail Store Law and replace it with the Large-Scale Retail Location Law (LSRSLL) on June 1, 2000. The new Law provides that regulation of large stores will no longer be based on supply/demand considerations, but upon the degree to which a large store opening or expansion affects the local environment, particularly traffic, noise, parking, and garbage removal. Japan also amended its City Planning Law in November 1998 to afford local authorities greater freedom in zoning decisions.

While the United States welcomed the abolition of the Large-Scale Retail Store Law, it has expressed strong reservations with regard to the new legislation. The manner in which the new LSRSLL and the revised City Planning Law are implemented will determine whether they are improvements over the Large-Scale Retail Store Law and afford greater market access for large stores. Accordingly, the United States expects MITI to fulfill its stated intention to apply public comment procedures to the draft environmental guidelines, ministerial ordinances, and other measures necessary to implement the new law.

However, the United States remains extremely concerned with the possibility for abuse or inconsistent application of the new authority by local governments. Accordingly, it has urged the Japanese Government to: (1) clearly and precisely formulate and make public all of the criteria and procedures that local governments will be allowed to use in considering the establishment or expansion of large-scale retail stores; (2) clearly and narrowly define the authority of local governments in exercising their new authority; (3) establish close and continuous central government monitoring of local governments' implementation of the new authority; (4) establish a central government monitoring and appeals mechanism that would allow retailers to obtain prompt review and redress of decisions by local authorities that unreasonably restrict the introduction or expansion of large-scale retail stores; and (5) ensure that local governments do not use recent amendments to the City Planning Law to impose unreasonable restrictions on the location of large retail stores. The United States has also urged the Japanese Government to ensure that the transition between the old and new systems is smooth and does not impede the opening or expansion of large stores or discourage retail investors from planning an orderly expansion of their business. The United States will continue to closely monitor the implementation of the new Law.

Transportation and Warehousing: Japanese laws limit competition and raise costs in the trucking business by, among other things, requiring new entrants to meet minimum number of vehicle requirements and

imposing burdensome rate filing requirements on companies. The United States has asked Japan to (1) establish

a generally available nationwide trucking operating license that would be used by international companies serving Japan wishing to engage in intermodal shipping operations; (2) remove any district licensing requirements for trucking services that specify a minimum number of vehicles; (3) eliminate pricing restrictions on freight forwarding; and (4) reduce significantly the restrictions on entry in the warehouse sector, including licensing and notification requirements, in order to reduce shortages of storage space, lower high fees, and minimize burdens for foreign firms in distributing their products.

Transparency and other Government Practices

Greater transparency and increased opportunities for public participation in Japan's regulatory system are essential complements to effective sectoral deregulation in Japan, and will lead to a more effective and accountable regulatory system. An improved regulatory environment would play an important role in reducing market access barriers faced by foreign firms in Japan.

Lack of Transparency in Regulatory System: Foreign firms are disadvantaged by the lack of transparency in the Japanese regulatory system. As a consequence, the United States has long pressed Japan to make its administrative procedures and practices more open and transparent. Under the Enhanced Initiative, the United States has raised specific concerns, including the following:

Lack of an Information Disclosure Law: Japan has not yet enacted an information disclosure law, comparable to the U.S. Freedom of Information Law, which would give foreign firms, as well as the Japanese public, access to records and other information under the control of governmental entities. A U.S. priority under the Enhanced Initiative has been the expeditious enactment and implementation of an information disclosure law to provide the public with effective access to government information. In March 1998, the Japanese Government submitted information disclosure legislation to the Diet, and on February 17, 1999, the Lower House passed the legislation. Although the United States has continued to urge Japan to subject public corporations (*tokushu hojin*) to information disclosure requirements, they are not covered by the pending legislation.

Development of a Rulemaking Process: Traditionally, ministries and agencies have prepared regulations in a "black box", that is, regulations have been created and adopted without interested parties being provided opportunity for notice and comment. Those limited opportunities for comment which have been afforded have generally been extended only to bureaucrats, former bureaucrats and special interest groups. Others with an interest in proposed regulations are generally denied an opportunity to take part in the process. Under a notice and comment process, all governmental entities would be required to publish proposed regulations, provide a reasonable opportunity for interested parties and the general public to comment on the proposed regulation, and give serious consideration to these comments in preparing the final regulation. In accordance with its 1998 Three-Year Deregulation Program and the First Joint Status Report under the Enhanced Initiative, the United States has set as a priority Japan's adoption of a notice and comment process that would enable all interested parties to participate effectively in the development of regulations. Japan is now preparing to introduce Public Comment Procedures.

In October 1998, Japan's Management and Coordination Agency (MCA) issued draft Public Comment Procedures, to be instituted in April 1999. The United States submitted, on December 10, 1998, extensive comments, in which it commended the MCA for using a transparent process in preparing the Procedures, and urged it to remedy potentially fatal flaws in the proposal. In particular, the United States objects to the extensive discretion afforded administrative agencies in deciding when to apply such procedures. In addition, the United States urged Japan to (1) require all ministries and agencies to use the procedures for all

regulations that they propose to adopt, modify or abolish, as well as legislative proposals that they propose,

unless they meet narrowly defined exceptions, (2) require all advisory councils, including *shingikai, kenkyukai, benkyokai* and *kondankai* to use the Procedures when they issue interim reports and draft recommendations; and (3) establish an independent review mechanism designed to hold administrative agencies accountable for failing to comply with such procedures.

Use of Administrative Guidance: The lack of transparency inherent in Japan's excessive and extensive use of informal directives or "administrative guidance" remains a serious concern to the United States. Despite the 1994 Administrative Procedure Law's requirements that Japan provide, upon request, and in writing, a copy of administrative guidance to (1) a private party receiving oral guidance from the government or (2) when it is issued to multiple persons, a Management and Coordination Agency survey indicates that there have been few instances where this has occurred. The United States has called upon Japan to increase the transparency of the use of administrative guidance, including requiring government entities to incorporate into administrative guidance a statement that compliance with it is completely voluntary, and that the recipient will not be treated disadvantageously for not complying with the guidance.

Use of Advisory Councils: Japan often relies upon advisory councils (*shingikai, kenkyukai, benkyokai* and *kondankai)*, established by ministries and agencies, to formulate policies and recommendations. While the councils have the appearance of objectivity and independence from the bureaucracy, in fact their members typically include former bureaucrats; their secretariats are staffed by bureaucrats of the affected ministry; and they are implicitly expected to endorse policies developed or advocated by the ministry. Under the Enhanced Initiative, the United States has called upon Japan to improve the transparency and objectivity of such advisory councils, in particular, by affording notice and comment opportunities in the preparation of reports and recommendations. The Central Government Reform Law, which was enacted in 1998, also calls for reform of the advisory council process.

Need for Improvement of the Application Process: Despite provisions of the 1994 Administrative Procedure Law, which were designed to standardize administrative procedures, and make them more transparent and fair, U.S. firms have repeatedly complained about the burdensome and unpredictable nature of the application process in Japan. Potential applicants for licenses, permits and other approvals often must engage in extensive "prior" consultations with governmental entities and satisfy numerous requests for additional information before they are allowed to submit their application to the relevant ministry. Such prior consultations may take six months to a year or more. Repeated requests for more information appear to arise because the standards, criteria and other requirements used to evaluate an application often are not adequately set out in published regulations. Under the Enhanced Initiative, the United States has called upon Japan to remedy this situation.

IMPORT POLICIES

In the Uruguay Round, Japan agreed to "zero for zero" tariff eliminations on pharmaceuticals, paper and printed products, beer, whisky, and brandy, agricultural equipment, medical equipment, construction equipment, furniture, steel, and toys. Japan also adopted the chemical harmonization initiative. Japan cut tariffs on copper and aluminum, with the top rate reduced from 12.8 percent to 7.5 percent. Japan is one of the 43 signatories of the 1997 Information Technology Agreement, which eliminates tariffs on the overwhelming majority of covered products by 2000. Japan's remaining high tariffs affect primarily agricultural and food products, including white distilled spirits, processed food products, wood and wood products, and leather and leather products. Tariffs on white distilled spirits will be eliminated as a result of the December 1997 settlement of a WTO dispute.

At the APEC Leaders' meeting in Vancouver, Canada in November 1997, the United States, Japan and 16 other

APEC economies endorsed a program of accelerated trade liberalization measures (the Early Voluntary Sectoral Liberalization -- EVSL – initiative) in nine sectors: environmental goods and services, the energy sector, fish and fish products, toys, forest products, gems and jewelry, medical equipment and instruments, chemicals, and a telecommunications mutual recognition agreement. As the world's second largest economy, Japan's full participation in these initiatives was regarded as vital to ensuring their successful completion in 1998 as directed by APEC Leaders. Facing strong domestic pressure, Japan refused to participate in tariff reductions in the fisheries and forestry products sectors at the November 1998 APEC Leaders' Meeting, thereby blocking APEC's adoption of the policy package. However, it committed with other APEC nations to negotiate tariff reductions in all of the EVSL sectors in the WTO. The United States will press Japan to play a constructive role in concluding agreement at the WTO on this initiative in 1999.

Distilled Spirits

In July 1996, a WTO Dispute Settlement Panel ruled against Japan in proceedings initiated by the United States, Canada, and the European Union. The panel found that Japan's liquor tax regime discriminated against imported distilled spirits and was therefore inconsistent with Japan's WTO obligations. Unfortunately, the United States was forced to seek binding arbitration when it became apparent that Japan did not intend to bring its tax system into WTO compliance within a "reasonable period" as provided for under WTO rules. The arbitration ruling in February 1997 supported the position of the United States. After considerable negotiation, in December 1997 the United States and Japan reached a settlement ensuring that Japan would bring its liquor taxation system into WTO conformity. Furthermore, Japan also agreed to eliminate tariffs on all brown spirits (including whisky and brandy) and on vodka, rum, liqueurs, and gin by April 1, 2002.

Specifically, Japan is revising its liquor excise tax system in three stages: October 1, 1997; May 1, 1998; and October 1, 2000. Taxation rates for all distilled spirits were brought into WTO conformity by May 1998, with the exception of low-grade shochu. On May 1, 1998, the liquor tax for imported whiskey and brandy was reduced by 58 percent, while the tax on high-grade shochu was raised by 59%. The tax on low-grade shochu will be harmonized on October 1, 2000.

The U.S. distilled spirits industry reports that, as expected, the change in taxation has had a significant positive impact on exports of U.S. distilled spirits to Japan. In 1998, total exports of U.S. spirits to Japan increased by 23% over 1997 and grew faster than exports to other markets. The increase in U.S. distilled spirits exports is even more striking in light of Japan's current economic recession which has caused significant declines in overall U.S. exports to Japan.

The United States will continue to closely monitor Japan's implementation of this settlement to ensure that tax and tariff reductions are eliminated on the schedule agreed, and that no measures are adopted which would undermined the benefits of this settlement.

Varietal Testing

Japan restricts entry of certain U.S. fresh fruits, vegetables and other horticultural products, and many other products continue to face outright bans. Despite bilateral technical discussions over many years, there has been no progress in liberalization of products such as cabbage and fresh whole potatoes, which Japan continues

to prohibit without sufficient scientific evidence of legitimate plant quarantine concern.

U.S. agricultural products such as apples, cherries, walnuts and nectarines, continue to be subject to unnecessary phystosanitary restrictions. Japan requires repeated testing of established quarantine treatments each time a new variety of an already-approved commodity is presented for export from the United States.

After efforts to resolve the varietal testing issue through bilateral negotiations over many years proved unsuccessful, in October 1997, the United States invoked dispute settlement procedures against Japan's varietal testing requirements. This redundant requirement has no scientific basis and, because it imposes expensive and time-consuming testing on American producers, serves as a significant barrier to market access.

The United States challenged these requirements as inconsistent with Japan's obligations under the WTO Agreement on the Application of Sanitary and Phytosanitary Measures (the "SPS Agreement"). On October 27, 1998, a WTO dispute panel ruled in favor of the United States. The central panel findings were that Japan's varietal testing requirement is maintained without sufficient scientific evidence, in violation of the SPS Agreement Article 2.2, and inconsistent with Japan's transparency obligations under SPS Article 7 and Annex B, since Japan has not published its requirements. Both parties appealed the decision and, in February 1999, the Appellate Body affirmed this ruling and expanded product coverage of the initial panel report through a finding that Japan's requirement is not based on a risk assessment, in violation of Article 5.1. The additional products covered by this finding included: plums, pears, apricots and quinces. The Appellate Body report should result in new market opportunities for U.S. producers of these crops.

Fumigation Policies

Also of major concern is the lack of transparency in Japan's fumigation policies. Japanese plant quarantine regulations require fumigation of imported fresh horticultural products if, upon import inspection, a shipment is found to be infested with live insects regardless of whether these are considered serious plant pests or are already present in Japan. The fumigation requirement is particularly detrimental to trade in delicate horticultural products, such as lettuce and cut flowers, which generally do not survive the treatment and must be destroyed. In fact, Japanese produce importers report that if the risk of fumigation were eliminated, imports of U.S. lettuce would grow dramatically, to more than $100 million annually. Due to the high risk of product loss due to fumigation, sales now typically average less than $5 million per year.

After repeated requests by foreign governments for reform, MAFF has begun to implement a non-quarantine pest list by partially amending the Plant Quarantine Law to exempt 53 pests and 10 plant diseases from fumigation requirements. While this appears to be an important positive step, the list does not include common insects found on U.S. fresh fruits and vegetables. The United States will continue to press Japan in appropriate technical and deregulatory fora to develop a comprehensive list of non-quarantine pests and transparent inspection procedures in an effort to reduce excessive, unnecessary, and trade distorting fumigation.

Tomatoes-Tobacco Blue Mold

The United States remains concerned that Japan continues to restrict market access of tomatoes to all but a limited number of varieties due to its unsubstantiated concern that such tomatoes may carry tobacco blue mold. Japan's original concern was based upon a scientific citation dating from the 1940s that claimed tobacco blue mold disease might be carried on tomatoes. The scientific literature since then contains numerous citations that refute the original claim, yet Japan continues to rely upon it, clinging to the notion that tomatoes shown to be resistant or immune to the disease may be so owing merely to varietal differences.

In June 1998, the U.S. Department of Agriculture's Animal and Plant Health Inspection Service (APHIS) sent MAFF a letter outlining the U.S. scientific position on this issue. At a bilateral meeting between technical representatives from both countries in September 1998, the U.S. requested that MAFF hold a public meeting to authorize the importation of all varieties of U.S. tomatoes, since there is no scientific evidence that U.S. tomatoes are capable of transmitting tobacco blue mold to Japan. MAFF responded in December 1998 by stating that there is no scientific evidence that field grown tomato fruit are a host of tobacco blue mold. While this is a welcome recognition, MAFF also indicated that it will need to study some related technical issues further.

While representatives of MAFF have indicated informally that the scientific questions have been answered and enough data have been provided to address this issue, this issue remains politically sensitive in Japan due to strong agricultural interests. It is the position of the United States that the February 1999 WTO Appellate Body decision (upholding earlier WTO dispute settlement panel findings) that Japan's variety-by-variety quarantine testing requirements are scientifically unjustified, should finally settle this issue. The United States pressed these concerns at senior levels in 1998, and will continue to do so in 1999.

Fish Products

Japan maintains nine global and two bilateral import quotas on fish products. U.S. fishery exports to Japan subject to import quotas (IQ) include pollock *tsurimi*, pollock roe, herring, cod, mackerel, whiting, squid, and several other fish products. These quota-controlled imports into Japan account for sales of hundreds of millions of dollars annually.

In 1998, Japan made substantial changes to the administration of the IQ system by the Ministry of International Trade and Industry (MITI), which improved information disclosure and transparency, by (1) making IQ allocations once a year instead of twice annually as in the past; (2) making allocations for each fish species at the same time each year; (3) announcing a breakdown of IQ amounts, by groups of recipients (such as processors, traders, fishermen, etc.); (4) providing the names and addresses of IQ recipients with their allocation amounts; and (5) disclosing, later, the actual amount imported by each IQ holder.

In administering the fish and shellfish IQ, which covers a number of species, MITI now provides a breakout for mackerel, jack mackerel and sardines by quantity rather than value. This information helps U.S. exporters plan their transactions by species.

The fisheries sector was identified as one of nine sectors for Early Voluntary Sectoral Liberalization (EVSL) under APEC. Fish exporting countries, including the United States, urged Japan to liberalize trade in fishery

products through eliminating tariffs, facilitating investment, and promoting economic and technical cooperation. At the November 1998 APEC Leaders' Ministerial Meeting in Kuala Lumpur, Japan refused to participate in

tariff cuts in the fisheries sector, arguing that such a policy would result in over fishing, devastate marine living resources and benefit flag-of-convenience vessels and non-members of regional fishery management organizations. However, at the Kuala Lumpur Meeting, Japan agreed to language in the Ministerial Declaration that commits it to participate in negotiations on the tariff elements of the sectoral initiatives developed by APEC in the WTO "with a view towards further improving....participation and endeavoring to conclude agreement in the WTO in 1999; and by working constructively to achieve critical mass in the WTO, necessary for concluding agreement in all 9 sectors." The United States will press Japan to play a constructive role in concluding an agreement at the WTO in 1999, with a view towards eliminating fisheries product tariffs in the 2002-2004 time frame.

General Food Products

In the Uruguay Round of the General Agreement on Tariffs & Trade, Japan agreed to bind tariffs on all agricultural products and to reduce bound rates by an average of 36 percent during 1995-2000, with a minimum 15 percent reduction on each tariff line. Japan also agreed to gradually reduce tariffs on imports of beef, pork, fresh oranges, cheese, confectionery, vegetable oils, and other items. Even after full implementation of the Uruguay Round cuts however, imports of many intermediate and consumer-oriented food and beverage products will still face relatively high tariffs, including beef, fresh oranges, fresh apples, citrus and other fruit juices, corn grits, confectionery, snack foods, ice cream, and processed tomato products.

Japan also agreed in the Uruguay Round to convert all import bans and quotas (except for rice) to tariffs, which would be reduced between 1995 and 2000. Tariff rate quotas replaced import quotas for wheat, barley, starches, peanuts, and dairy products. Japan retains state trading authority and price stabilization schemes for these products but is currently studying proposals to liberalize imports to a small degree. Imports of many packaged food items have been hampered due to high tariffs (22-24 percent *ad valorem* for confectionery products and 24 percent *ad valorem* for cookies and biscuits) Imports of wines also face 21 percent *ad valorem* duty.

The United States is closely monitoring Japan's implementation of the Uruguay Round measures for agriculture (particularly imports and exports of rice) and safeguard measures for beef and pork. Our bilateral efforts have also focused on countering any technical or food safety-related measures, such as product standards and labeling issues, that threaten to impede imports.

Import Clearance Procedures

Despite progress in recent years, Japanese import clearance procedures remain slow and cumbersome by industrial country standards, resulting in increased costs for both U.S. exporters and Japanese consumers alike.

Continuing U.S. and Japanese Government efforts to improve import clearance are being discussed under the Enhanced Initiative, as well as in regular bilateral consultations between customs agencies. These discussions have helped promote changes in Japan's import processing procedures including eliminating the requirement to process all air cargo through a separate cargo holding area (Baraki-cargo area 30 kilometers from Tokyo's

Narita airport); instituting a computerized customs processing system; integrating that computer system with inspection authorities from the Ministry of Health and Welfare and the Ministry of Agriculture, Forestry and

Fisheries; and establishing a pre-arrival customs clearance procedure.

Although these changes have resulted in a reduction in the average time required for customs clearance, problems remain. Average processing times in Japan, for example, remain slow relative to other advanced industrial countries. A WTO secretariat review of Japanese customs procedures concluded that clearance times remain quite high by developed-country standards, apparently not because of official clearance procedures per se, but due to logistical issues such as pre-processing and warehousing. U.S. companies have endorsed the following four elements drafted by the World Customs Organization (WCO) to simplify and streamline customs processing: (1) releasing cargo on the provision of minimum information necessary to identify cargo and permit the completion of final customs declarations; (2) filing a single customs declaration for all imports in a given period where cargo is imported frequently by the same person or enterprise; (3) clearing cargo at declarants' premises or another authorized place; and (4) using importers' commercial records to self-assess duty and tax liability and to ensure compliance with other customs requirements. At the last WCO meeting in June 1998, Japan opposed making all four elements mandatory. The draft text was subsequently amended to make elements (1) and (3) mandatory with the other elements to be adopted "to the extent possible." The United States urges Japan to support the current text.

Moreover, the U.S. Government and U.S. companies urge Japan to permit private facilities to conduct the same bonded warehouse functions as currently exist at Tokyo's Narita airport, and to allow direct transfer to these facilities. These changes are needed in order to meet the greatly increased cargo volume expected after a second runway at Narita airport is completed in 2001.

In addition, user fees remain high. Importers complain that the Nippon Automated Cargo Clearance System (NACCS) is prohibitively expensive and difficult to use. Overtime processing charges are artificially high because a maximum number of shipments are allowed per hour, even though a much greater number of shipments could be cleared now since the system is automated. Warehouse charges are high because each shipment is charged a minimum of 80 hours of storage time, despite the fact that average processing time is only 31 hours. The *de minimis* value for exemption is also quite low at 10,000 yen (less than $100), significantly increasing the cost of importing relatively small value items. This also requires considerable processing time, and discourages orders from catalog retailers. Additionally, Japan is the only advanced industrial country to use a "cost, insurance, freight" (CIF) basis in calculating its duties, rather than a "free on board" (FOB) basis which increases costs.

Finally, customs processing hours of operation are short. A change, from 8:30 AM-5:00 PM to 6:00 AM-10:00 PM hours of operation every day, including Saturdays, Sundays, and holidays, would bring processing hours for cargo in line with processing hours for passenger baggage, greatly benefitting importers and facilitating onward transportation. U.S. companies have also requested that Japan establish procedures to effect customs release of cargo 24 hours per day by implementing a surety bond system, bank guarantee, or "round-the-clock" bank clerk.

Given the wide-ranging effect of customs clearance costs and delays on current and potential U.S. exporters, catalog retailers, courier services, and Japan-based enterprises which require the importation of goods and equipment, it is difficult to estimate the dollar effect of streamlining Japanese customs procedures. However,

one U.S. courier has estimated that changing the *de minimis* exemption alone would reduce annual duties by tens of billions in yen, while encouraging dramatic increases in orders from Japanese consumers.

Leather

In 1991, Japan liberalized treatment of footwear imports, setting a footwear quota of 2.4 million pairs per year. By JFY 1998, it had raised that quota to roughly 12 million pairs per year. In the Uruguay Round, Japan committed itself to reduce tariffs over an eight-year period on under-quota imports of leather footwear, crust leather and other categories. The U.S. Government and U.S. leather and leather footwear industries continue to push for elimination of the quotas.

Above-quota imports of footwear still face stiff barriers. The above-quota tariff is currently 48.8 percent or 4,612.50 yen per pair, whichever is higher. These rates will drop to 30 percent or 4,300 yen, whichever is higher, by 2002. In principle, the over-quota tariff rate will be reduced by 50 percent and the yen minimum alternative rate by 10 percent over the eight-year phase-in period. In practice, however, the yen minimum alternative rate is applied in a manner that negates the effect of the larger tariff rate reduction. Moreover, while above-quota imports grew substantially in JFY 1996, they still totaled only about 7.7 percent of under-quota imports. This suggests that the higher rates for above-quota imports are discouraging additional imports.

Rice

Japan's highly protected rice market has long been a target for liberalization efforts. During the GATT Uruguay Round, Japan agreed to begin to open its domestic rice market and establish a minimum access commitment for rice imports. Under this agreement, Japan committed to import 379,000 metric tons in 1995/1996. This quota was to grow to just over 758,000 tons at the end of the Uruguay Round implementation period (2000/2001). Since the Uruguay Round, the United States has been the single largest foreign supplier of rice to the Japanese market, supplying approximately one-half of Japan's total imports.

In December 1998, Japan notified the WTO of its intention to convert Japan's current minimum access commitment for imported rice to a tariff-rate quota (TRQ). The shift to a TRQ, which is provided for in annex 5 to the Uruguay Round's Agriculture Agreement, would replace the current absolute quota. By switching to a TRQ, Japan will be allowed to slow the rate of growth of the minimum access commitment in the final two years of the Uruguay Round implementation period. Tariffication will result in a decrease of the minimum access commitment in 2000/2001 to 682,000 tons, a decline of about 76,000 tons of rice.

The U.S. rice industry has worked assiduously to meet the demands of the Japanese market. In cooperation with its Japanese customers, it has improved its production, handling, and milling techniques for the unique varieties that are produced specifically for the Japanese market. In light of these impressive efforts, the United States held a number of discussions with the Japanese Government in the wake of its WTO notification to examine the effects of its new policies on access to Japan's rice market. Through these talks, the U.S. Government made it clear that it expects the U.S. rice industry to achieve continued access to Japan's rice market in line with that of the past four years. It will work with Japan in 1999 and beyond to that end, and will closely monitor Japan's rice purchases. If circumstances change, the United States reserves the right to consider all options to respond to this policy, including the WTO. At the same time, the United States and Japan plan to hold periodic consultations on a number of agricultural issues, including access to Japan's rice market. As a result of these discussions, the United States decided not to object to Japan's new rice import regime in the WTO at this time.

Wood Products/Housing

Japan is the United States's top export market for wood products. Japan's recession thus has taken its toll on

U.S. exports of these goods. The slowdown caused a deep slump in its housing market, which in turn reduced demand for wood products. U.S. exports of forest products in 1998 totaled $1.6 billion, down 35 percent from 1997 levels. Reflecting Japan's sharp tariff escalation in this sector, U.S. exports of value-added wood products (from lumber to finished goods) fell even more sharply. The share of value-added goods in U.S. wood product exports to Japan fell from 34% in 1997 to only 25% in 1998.

There is much that the Japanese Government can do to restore and expand its wood products market. Among other things, it should take steps to rebuild consumer confidence, implement tax reform measures to stimulate home purchases, eliminate subsidies for its domestic wood products sector, and implement performance-based codes and standards under the revised Building Standards Law.

Japan has resisted the elimination of tariffs on wood product tariffs, a key U.S. objective. At the November 1998 APEC Leaders' Meeting, Japan refused to participate in tariff cuts in the forestry sector, but committed with other APEC nations to negotiate tariff reductions (in this and seven other sectors) in the WTO. The United States will press Japan to play a constructive role in concluding an agreement at the WTO in 1999, with a view towards eliminating wood product tariffs in the 2002-2004 time frame.

Housing has been designated as one of five priority sectors under the U.S.-Japan Enhanced Initiative on Deregulation and Competition Policy. It is described in further detail in that section.

STANDARDS, TESTING, LABELING AND CERTIFICATION

Certification-related problems continue to obstruct access to Japan's markets. Although advances in technology continue to make Japanese standards outdated and restrictive, Japanese industry continues to support safety and other standards that are unique only to Japan and which restrict competition. In some areas, however, the Government of Japan has undertaken to simplify, harmonize, and eliminate restrictive standards in accordance with international practices.

The principal organization that adjudicates standards and certification disputes between foreign companies and the Government of Japan is the Office of the Trade and Investment Ombudsman (OTO). In 1994, the Office of the Trade and Investment Ombudsman came under the Prime Minister's office and was authorized to recommend actions to appropriate ministries. The Office of the Trade and Investment Ombudsman has had some modest impact, but still lacks formal enforcement authority.

Biotechnology

Japan has taken a scientific approach to regulating trade in agricultural biotechnology products made using genetically modified organisms (GMOs). To date, the Ministry of Agriculture, Forestry and Fisheries (MAFF) and the Ministry of Health and Welfare (MHW), which regulate biotechnology products, have approved the importation of 22 GMO varieties, including corn, potatoes, cotton, tomatoes, and soybeans.

While U.S. and Japanese regulatory approaches to biotech products have been closely aligned, MAFF has proposed new mandatory labeling requirements for GMOs that, if implemented, could significantly disrupt imports from the United States. The United States believes that labeling should convey essential ingredient and nutritional information and must be truthful, informative, and not mislead consumers. Requiring labeling when there is no health or safety risk discriminates against products produced through biotechnology and

suggests a health risk where there is none. The United States expressed its concerns during MAFF's public comment period, and continues to urge the Japan not to proceed with unnecessary and inappropriate labeling requirements that could hinder the continued development of this important technology.

Dietary Supplements

Dietary supplements (vitamins, minerals, herbs, and non-active ingredients) have traditionally been classified as drugs in Japan, imposing severe restrictions in the Japanese market on the shape, dosage, and retail format for such supplements. These regulations create excessive costs and difficulties for most foreign supplement firms participating in the Japanese market, thus, contributing to the weak presence of U.S. firms. Dietary supplement issues are addressed by the United States through the MOSS/Enhanced Initiative process.

In March 1996, Japan's Office of Trade and Investment Ombudsman (OTO) recommended that products normally distributed and sold abroad as food products should not be regulated as drugs, but be allowed into the market as food products in Japan. However, since the release of these recommendations, MHW has significantly slowed the pace of such liberalization and has fallen far behind the schedule recommended by the OTO. The Ministry established study groups composed of government, industry, and academic experts to study each category of dietary supplements but the work of these study groups has become delayed. Ministry of Health and Welfare actions to date raise concerns that it will not accomplish the task set for it by the OTO. For example, the MHW identified in March 1997 seven vitamins to be treated as foods and six other vitamins to be treated as food only if sold in doses of less than 1.5 U.S. RDA. The basis for the Ministry's decision was unclear, as is the status of the vitamins which were not clearly treated as foods. The United States views the slow pace of this process, and unlikely prospects for timely reform, as a continuing concern.

In March 1997, the Ministry of Health and Welfare identified seven vitamins to be treated as foods and six other vitamins to fall between pharmaceutical and food regulations. The basis for the Ministry's decision was unclear, as is the status of the six vitamins which were not clearly treated as foods. A further concern arises from the fact that even those seven vitamins now treated as foods face insurmountable barriers when marketing in tablet form due to the fact that common excipients used to make such tablets do not appear on the positive list of food additives under Food Sanitation Law. Therefore vitamins containing these excipients still cannot be sold in Japan.

The treatment of dietary supplements as food products does not fully solve the marketing and labeling problems U.S. industry has faced in the past because as food products, dietary supplements must now adhere to the food additive restrictions of the Food Sanitation Law (FSL). Such is the case with sodium lauryl sulfate which is used in gel caps and is acceptable in medications, but is not part of the FSL's positive list for food additives. Another problem presented by the FSL is that some naturally occurring compounds, such as benzoic acid and sodium benzoic that is found in ginkgo biloba, are also considered food additives. Accordingly, such restrictions makes the marketing such products without major reformulations impossible.

The Administration will continue to engage MHW in the MOSS/Enhanced Initiative process, the OTO, and other fora, to improve market access for U.S. dietary supplements through full and meaningful implementation of the OTO recommendations.

Food Additives

Processed food imports into Japan often are obstructed by Japanese Government standards affecting food additives, even though those additives may be approved as safe in other countries by the Joint FAO/WHO

Experts Committee on Food Additives. Japan refuses to allow the importation of light mayonnaise (as well as creamy mustard) containing food additive potassium sorbate, a food additive widely recognized as safe, although many other food products containing this additive are permitted to enter Japan, including soy sauce.
Japan is revising its Food Sanitation Law to bring its processes for assessing food additives into conformity with

the World Trade Organization (WTO) Sanitary and Phytosanitary (SPS) measures. Still, Japan's food additive regulations remain unusually restrictive, especially the listing of "non-natural" additives designated by the Ministry of Health, Education and Welfare (MHW) pursuant to Article 6 of the Food Sanitation Law. The U.S. Government encourages U.S. firms and industry associations to file applications with the MHW, allowing sufficient time for assessment. The United States has raised Japan's regulation of food additives in bilateral talks on deregulation and intends to continue to press this issue.

Pesticides Residues

The Ministry of Health and Welfare continues to establish new residue standards for pesticides, and to provide full notification to the WTO and the opportunity for comment and review. The U.S. Government is providing scientific data pertaining to relevant U.S. and international standards for the chemicals concerned.

While Japan has made progress in establishing pesticide residue standards in line with internationally recognized tolerance levels, further government action remains necessary to help counter misleading information regarding the safety of imported food and agricultural products.

Veterinary Drugs

The United States is also concerned by Japan's safety review process for veterinary drugs. Japan's practice of waiting for CODEX to adopt an international standard before evaluating scientific evidence results in unnecessary delays in establishing tolerance levels for veterinary drugs in Japan. Japan's policy of prohibiting detectable residue levels of these drugs, without conducting a risk assessment in a timely manner, appears to be inconsistent with Japan's obligations under the WTO SPS Agreement. The United States has urged Japan to undertake evaluation of scientific evidence in order to establish tolerance levels for new veterinary drugs in a timely fashion, and not to delay the process waiting for the outcome of CODEX deliberations.

GOVERNMENT PROCUREMENT

The U.S. Government has implemented bilateral agreements with Japan in six key sectors of the Japanese public sector market: computers, construction, medical technologies products and services, satellites, supercomputers, and telecommunications equipment and services. The aim of these agreements is to improve foreign firm's access to, and expand sales in, the Japanese public procurement market. In support of this, the agreements attempt to redress traditional Japanese procurement practices which have historically prevented U.S. and other foreign firms from fully and equally participating in the Japanese public sector market. In general, the agreements provide equal access for foreign and domestic suppliers to all public information at all phases of the procurement for upcoming procurements; ensure equal opportunity to comment on and participate in the development of specifications; provide for a reduction in the number of sole-sourced procurements; and require an impartial bid protest system. However, while there has been some notable progress made under the Medical Technology, Satellite, and NTT Agreements, results to date under several of the other bilateral government procurement agreements have been disappointing.

The United States continues to press Japan to make further efforts to expand opportunities for foreign companies in the Japanese public sector in order to achieve the joint aims of these important agreements. Further, in light of recent announcements by the Government of Japan that current and future supplementary

spending packages will be focused on "21st Century Technologies" as well as traditional public works -- both areas covered by our bilateral Government Procurement Agreements -- comprehensive and effective implementation of these agreements at this time is essential.

Computers

U.S. makers of computer goods and services are global leaders in technology and performance and continue to be among the largest and most successful foreign firms in Japan. Because they have long been under-represented in the Japanese Government market for computers (where their share has been one third or less than their share of the larger, more competitive Japanese private sector market), the United States and Japan concluded the bilateral Computer Agreement in 1992. Under the agreement, the Japanese Government agreed to institute changes to its procurement practices with the aim of expanding government purchases of foreign computer products and services.

Regrettably, results from the agreement have been unsatisfactory and the United States is increasingly dismayed by the significant downward trend in Japan's public procurement of foreign goods and services in this sector. In fact, U.S. industry data indicate that foreign computer manufacturers' share of the Japanese Government personal computer market has declined steadily since the bilateral Computer Agreement was concluded in 1992. This share now stands at a mere 7.7 percent – down a striking 49 percent since 1992. Results under the agreement for mid-range and mainframe computers is only slightly better. Industry data show that while the foreign share of this market increased slightly from 1992 to 1994, it declined during the next two years, falling to 9.3 per cent of the market in 1996. This market share is barely above the 8.9 percent share foreign firms held in 1992. Even the Japanese Government, which has historically reported a higher foreign share of this market than U.S. company data indicates, reported a dramatic 37 percent drop (from 25.2 percent to 15.9 percent) in procurement from foreign sources between 1995 and 1996, leaving the current foreign market share roughly equivalent to the 15.5 percent foreign companies held when the agreement was implemented. These data compare unfavorably with a fairly consistent foreign market share of more than 30 percent of Japan's private sector computer market.

At the annual bilateral review of the agreement in Washington D.C. in August 1998, the United States expressed serious concern over the significant drop in the foreign share of the Japanese Government computer market and the fact that the joint aim of the agreement is not being achieved. The United States also noted continuing concerns about problematic procurement practices that the agreement was intended to stop, such as: (1) use of sole-sourcing of procurements by government agencies, particularly as related to important systems integration contracts; (2) unjust low-priced sales by Japanese manufacturers; and (3) unequal access to bidding information. We note that sole-sourcing by the Japanese Government, in this and other sectors, is actually increasing rather than decreasing as called for under the agreement.

In light of this situation, and taking into account technological advancements in the computer sector, the United States presented Japan with a series of proposals designed to enhance transparency and fairness in Japanese Government computer procurement to better enable us to achieve the joint aim of the Computer Agreement. The proposals, which are consistent with what Japan has already agreed to in other procurement agreements covering Medical Technology and Telecommunications, center on the broader adoption in Japan of the overall greatest value method (OGVM) bid evaluation system, which allows factors other than price to be taken into account in procurement decisions, as well as the provision of more information about upcoming procurements. The proposals are still under discussion.

Construction, Architecture and Engineering

The United States is seriously disappointed with the lack of progress under the U.S.-Japan public works agreements (the Major Projects Arrangement and the 1994 U.S.-Japan Public Works Agreement, which includes

the Action Plan on Reform of the Bidding and Contracting Procedures for Public Works). Between the 1997 and 1998 annual bilateral reviews of these agreements, foreign design and construction firms won only $50 million in contracts. This is about half of the previous year's figure of $100 million and substantially less than one percent of Japan's $250 billion public works market. (The peak of U.S. participation in Japan's public works market was $300 million in 1989.) Although American companies have won a few contracts since the June 1998 review, including three out of five procurements awarded to U.S.-Japan teams for Central Japan International Airport, the United States remains very concerned by the low value of these contracts overall. If procurements remain at the current pace, foreign firms are unlikely to surpass last year's very low $50 million figure.

At the U.S. Government's request following the discouraging outcome of the 1998 annual review, the U.S. and Japanese Governments met for special interim consultations in January 1999. These consultations were focused on the two major areas for improvement highlighted during the 1998 review: (1) the very low number of design/consulting projects open to foreign firms, and (2) arbitrary restrictions on joint venture formation for large construction projects in Japan's public works market. No progress was made in relaxing joint venture requirements for construction projects. However, Japan's Ministry of Construction made two proposals in the design/consulting area, including allowing design/consulting firms greater freedom to partner on projects and combining design contracts in a way that could lead to more opportunities for foreign firms. Although the United States raised some concerns regarding the implementation of these initiatives, the United States considers them to be positive steps and will monitor developments closely to ensure these policy changes do, in fact, translate into greater opportunities for American companies.

The United States strongly urged Japan to take additional steps in both the design/consulting and construction areas that would lead to significant progress and more business opportunities for American companies before the next annual review (tentatively scheduled for July in Tokyo). The United States proposed that the 1999 annual review be held at the Under Secretary level because of the severe market barriers facing U.S. firms.

The United States is monitoring several major projects covered by the U.S.-Japan public works agreements, including the Central Japan International Airport, Kansai International Airport Second Runway Construction, New Kitakyushu International Airport, and the Kyushu University Relocation Project. Japan's public works market is expected to grow substantially over the coming year, largely through the implementation of various fiscal stimulus packages. During the January consultations, the U.S. Government highlighted a number of projects funded by such packages which are of particular interest to American companies, including several covered by the U.S.-Japan public works agreement.

Medical Technology

The United States and Japan concluded the Medical Technology Procurement Agreement in November 1994, with the goal of significantly increasing market access and sales of competitive foreign medical products and services in the Japanese public sector procurement market. U.S. firms are the world’s largest producers of advanced medical technologies and this agreement provides an important step forward in enabling U.S., as well as other foreign firms, to more effectively sell medical technology products and services in Japan's public sector.

The agreement sets out fair and transparent procedures that must be used by governmental entities in procuring major medical equipment and services. The agreement also contains a set of quantitative and qualitative criteria upon which its implementation may be annually assessed, including value and share of contracts awarded to foreign firms by each government entity; number and value of contracts awarded through single tendering; and

foreign access to procurement information.

A key element of the agreement is the requirement that procurement decisions for central government purchases above a specified threshold (lowered to 385,000 Special Drawing Rights on April 1, 1998) be made on the basis of the overall greatest value method (OGVM) of bid evaluation, instead of lowest-bid. This is important because U.S. equipment is generally more innovative and offers special features or extraordinary performance and OGVM permits procurement decisions based not just on initial price, but on a complete assessment of the product's value over its life cycle. This ensures buyers the flexibility to select products based on the most favorable combination of price and performance.

Japanese central government entities use OGVM in selecting medical equipment valued above the established thresholds, and have reportedly found the methodology to be very effective in procuring the kinds of equipment they need to provide high quality medical care to their patients. Prefectural and municipal hospitals however have been obligated under Japanese law to exclusively utilize the "lowest-bid procedure" of evaluation, hindering the ability of U.S. companies to sell in this significant portion of the Japanese market. Under the agreement, Japan is required to encourage prefectural and local governments to utilize measures similar to those adopted by the central government entities.

In the March 31, 1998 Deregulation Action Plan announced by the Japanese Government, the Ministry of Home Affairs announced its intention to review local law and to undertake necessary measures to allow prefectural and local governments to use OGVM in bid evaluation. Accordingly, on February 17, 1999, the Cabinet adopted a Cabinet Order to permit the use of OGVM in bid evaluations undertaken by local and prefectural entities. This new policy should serve to expand market access in Japan for U.S. exporters and manufacturers of, not only highly advanced medical devices, but of all types of technologically advanced products. According to U.S. industry estimates, this measure could represent total U.S. sales increases in Japan of approximately $500 million ($100 million in medical devices.)

In 1995, the estimated foreign market share of government procurement covered by the Medical Technology Procurement Agreement totaled 38.6 percent. The foreign market share rose slightly in 1996 to 41.2 percent. Japanese public sector procurement addressed by the arrangement provisions topped 75 billion yen in 1996 -- or about $700 million. Preliminary data for calendar year 1997 indicate a slightly higher foreign company share.

The United States is satisfied to this point that Japan is fulfilling the objective of the Medical Technology Procurement Agreement to provide greater market access and sales in its government procurement sector. The United States will use the next review to press for continued compliance with the agreement's provisions.

Satellites

Under the 1990 U.S.-Japan satellite procurement agreement, the Japanese Government committed to open non-R&D satellite procurements to foreign satellite makers. Coverage includes procurement for broadcast satellites by NTT and NHK, the government-owned television/radio service.

To date, the agreement has been successful in opening the Japanese Government procurement market to foreign competition. From 1990 to 1997, U.S. satellite makers – world leaders in this field – won all five

contracts (with a combined value exceeding $1 billion) openly bid under the competitive procedures outlined in the agreement. Given U.S. industries' strength in this area, the U.S. Government expects that the success will continue.

A particular concern of the United States in this area is the definition of "research and development (R&D) satellites." The United States recognizes that R&D satellites can be excluded from open bidding under the agreement, but has raised with the Japanese Government concerns that an overly-broad definition of R&D could unfairly deny U.S. and other foreign satellite makers access to procurement opportunities. The United States has emphasized that "R&D procurements" must be consistent with the definition outlined in the bilateral agreement. Specifically the United States contends that they: (1) incorporate technology new to either country that is to be used entirely, or almost entirely, for the purpose of in-space development and/or validation of the new technology; (2) are not intended for the provision of commercial or regular services; and (3) do not finance the development of satellites or satellite componentry that can be used in the commercial or non-R&D government market.

The United States continues to carefully monitor Japan's adherence to the terms of the agreement, especially in light of recent Japanese Government announcements related to future satellite procurements.

Supercomputers

The United States and Japan concluded the 1990 U.S.-Japan Procedures to Introduce Supercomputers to ensure fair access for U.S. supercomputer manufacturers to Japan's high-performance computing market. Under the 1990 agreement, Japan committed to implement transparent, open, and non-discriminatory competitive procurement procedures for supercomputers in the Japanese public sector and to ensure that procuring entities are fully able to procure the supercomputer that best enables them to perform their missions.

Results under the 1990 Supercomputer Agreement have, generally, been unsatisfactory, and a significant gap still exists between the U.S. share of the competitive Japanese private sector market for supercomputers and the Japanese public sector market. After a notable increase in the U.S. share of Japanese public sector supercomputer market in FY93 and FY94, which brought it close to U.S. firms' 45-50 percent of the Japanese private sector supercomputer market, more recent results under the agreement have been disappointing. U.S. firms won only one of 11 procurements in FY95, two of eight procurements in FY96, and only one of five procurements in FY97. In addition to the discrepancy between U.S. share of the public and private sector markets, the United States is disturbed by a continuing trend whereby nominally competitive GOJ supercomputer procurements are attracting only one bidder. This is a possible indication that the private sector does not perceive these procurements to be sufficiently open.

During the annual bilateral consultations on the agreement in Washington D.C. in August 1998, the United States raised concerns over Japan's implementation of the agreement, specifically over its use of inappropriate technical requirements in public supercomputer procurements. The United States has emphasized that this practice is inconsistent with the terms of our bilateral agreement and is, therefore, unacceptable. The United States will continue to press Japan to ensure that the terms of the bilateral supercomputer agreement are faithfully implemented, including the use of neutral and nondiscriminatory technical requirements.

The United States and Japan also agreed at the August 1998 consultations to initiate discussions on revising the threshold for coverage under the agreement to take account of advances in computing technology since the coverage threshold was last revised in 1995. This discussion is ongoing.

Telecommunications

NTT Arrangement: NTT, which is Japan's single largest purchaser of telecommunications equipment, accounts for about one third of Japan's $35 billion telecommunication equipment market. As such, the "NTT market"

has been of key interest to U.S. and other foreign telecommunications firms. In September 1997, the NTT procurement arrangements were renewed for the sixth time since 1980, when the initial arrangement became effective. The renewed arrangements improved NTT procurement procedures to increase procurement transparency, enhance access to technical specifications and other information needed to prepare bids, and promote increased reliance on international standards. In addition, NTT Communication-ware Corporation (NTT COMWARE) joined three other NTT subsidiaries (NTT Data Communications, NTT Mobile Communications, and NTT Power and Building Facilities) in agreeing to voluntarily adopt the measures. The current arrangement is due to expire when NTT is restructured, currently scheduled to occur July 1, 1999. The two governments will initiate formal discussions on the future of the agreement in the Spring of 1999.

The United States and Japan conducted an annual bilateral review of the FY 1997 results of the improved NTT Arrangement in October 1998. During this review, NTT reported that overall procurement of foreign products increased from 173 billion yen in FY 1996 to 185 billion yen in FY 1997. The fact that overall NTT procurement of goods and services declined in FY 1997 made that increase all the more significant. The United States believes that this is an indication that the NTT Arrangement has been effective in bringing the United States closer to its aim of increasing competition and improving the openness, fairness, and transparency of the telecommunications market in Japan. Nonetheless, the United States has emphasized that there continues to be room for improvement. Despite the progress made over the last year, results to date under the NTT Procurement Arrangement still do not match the success foreign firms have achieved in other, more open, parts of the Japanese market and in telecommunications markets globally. U.S. firms have demonstrated remarkable international competitiveness and a strong commitment to the Japanese market. As such, the United States expects continued growth in NTT's procurement of foreign, and particularly U.S., equipment. As annual NTT procurements exceed $10 billion, the potential increase in U.S. telecommunications exports if NTT procurement practices are further liberalized is significant.

The differential between U.S. companies' success in their sales to the private Japanese telecommunications sector and their sales to NTT suggest that NTT is still reaping the benefits of its monopolistic legacy and is not fully responsive to market principles in its procurement. Evidence indicates that NTT continues to favor its "family companies" for the bulk of its telecommunications equipment purchases; that NTT continues to over-engineer and under-document specifications; that specifications are too often Japan-specific or NTT-specific; and that allocation of supplier market share for products is often based on non-transparent criteria. These practices raise costs to NTT and its customers, impede competition, and pose significant market access barriers.

NTT's practices hamper competition not only in the market for equipment, but for services as well. Across a spectrum of equipment categories, telecommunication service companies competing against NTT are required to use NTT-family developed equipment at considerably higher costs than comparable equipment available in international markets. To support a truly multi-vendor market for such equipment, and encourage cost-effective facilities-based competition, the standards, specifications, and interfaces for equipment connecting to the public switched network should not be determined solely by NTT and its family-companies, but should reflect international standards and be determined through a process which is open to all vendors or service suppliers.

Public Sector Procurement Agreement on Telecommunications Products and Services: The 1994 U.S.-Japan Public Sector Procurement Agreement on Telecommunications Products and Services was intended to significantly increase access for foreign telecommunications products and services in Japan's public sector. Pursuant to the agreement, Japan has introduced procedures to eliminate barriers such as: (1) unequal

participation in pre-solicitation and specification-drafting for large-scale telecommunications procurements; (2) ambiguous award criteria; and (3) excessive sole sourcing. The agreement also includes quantitative and qualitative criteria for measuring progress such as: (1) annual value and share of purchases of foreign products; (2)annual procurements of foreign products and services by entity; (3) contracts awarded for foreign products and services by entity; (4) annual numbers and values for contracts awarded as a result of single tendering; and (5) new subcontracting opportunities for foreign suppliers.

As in several other sectors, the United States remains concerned about the continued low foreign share of Japanese Government procurement of telecommunications products and services. The foreign market share in this important area rose only slightly between 1996 and 1997, increasing from 3.5 percent to 3.9 percent. This represents a significant decline from the 13 percent share of this market held by foreign firms in 1995. The United States will question whether all procurements covered by this agreement are in fact conducted in accordance with the agreement's provisions.

The United States also remains concerned about Japan's steadily increasing reliance on contracts awarded through sole source tendering. Despite the fact that the agreement calls for a reduction in sole sourcing, the share of total procurements for telecommunications equipment and services transacted through sole source tendering grew from 5 percent in 1994 to approximately 27 percent in 1997. The United States has urged Japan to take immediate steps to reverse this trend. Further, the United States objects to Japan's persistent failure to provide information on procurements made by the Japan Defense Agency, even though the agency is covered under the bilateral agreement. The use of international standards in this sector also remains a problem. The United States continues to urge Japan to increase its use of international standards rather than rely on often-outdated Japan-specific standards. Finally, the United States is maintaining pressure on Japan to ensure that information on procurements is provided to domestic and foreign companies on an equal basis. The next bilateral annual review of this agreement will be held in the Spring of 1999.

LACK OF INTELLECTUAL PROPERTY PROTECTION

When the Clinton Administration assumed office in 1993, it identified inadequate intellectual property protection as a serious structural barrier to U.S. economic interests in Japan. The United States has pursued its intellectual property goals with Japan through a firm policy that has combined close bilateral consultations and negotiated agreements (including two bilateral patent agreements from 1994); effective policy coordination in multilateral and regional fora; and strong action in the WTO when necessary to defend U.S. intellectual property interests in Japan.

The sound recordings dispute of 1996-97, which represented the first intellectual property dispute settlement case at the WTO, was resolved when Japan amended its law to fulfill its obligations in the U.S. favor. The result of this policy has been an increase in the level of protection afforded U.S. intellectual property in Japan, and a stronger Japanese role in pushing for stronger worldwide intellectual property protection. Although intellectual property piracy in Japan has dropped and significant improvements have been made to Japan's legal and administrative intellectual property framework, the United States has identified a number of areas where further action by Japan would be appropriate, including: (1) addressing persistent patent-related problems; (2) improving and expanding protection of copyrighted works; (3) speeding trademark application approval processes and expanding protection for well-known trademarks; (4) affording greater protection of trade-secret information; and (5) illuminating and gaining access to non-transparent border

enforcement mechanisms. Due to the existence of such concerns, in May 1998, Japan was again notified that it remains on the Special 301 "Watch List" of countries from which the United States seeks stronger intellectual property rights protection.

Patents

The United States remains concerned with elements of Japan's patent protection regime and has focused particular attention on improving registration access and approvals, and reforming Japan's practice of affording only narrow patent claim interpretation. Japan has taken steps to implement its commitments under two 1994 bilateral patent agreements, which: allow patent applications to the Japan Patent Office to be filed in English; permit the correction of translation errors after patent issuance; end dependent patent compulsory licensing (except in cases where anti-competitive practices have been found); end the practice of allowing third parties to oppose a competitor's patent before it is granted and to hear all opposition claims at the same time; and provide a revised accelerated examination system. Notwithstanding, the United States remains concerned with several aspects of Japan's patent administration including the relatively slow process of patent litigation in Japanese courts, the lack of an effective means to compel compliance with discovery procedures, and the lack of adequate protection for confidential information produced relative to discovery. Further, we remain concerned with the fact that Japanese courts generally require strict proof that a patentee's process is actually being used, creating burdens of proof which are particularly burdensome to foreign patent owners.

On February 24, 1998, the Japanese Supreme Court issued its first decision to permit an infringement finding under the "doctrine of equivalents." While the United States welcomes that decision, because patents in Japan continue to receive only a narrow scope of protection, we will closely follow lower court treatment of future similar cases.

The Japan Patent Office (JPO) has set a target of reducing the examination period further to 12 months by 2000. The JPO also plans to revise the patent law in 1999 to accelerate the period from patent application to approval (from the current maximum of seven to nine years to a maximum of three to four years); extend royalties retroactively to immediately following patent application; and to make it easier for plaintiffs to prove patent infringement in courts. The United States is encouraged by these steps which, if enacted, would further strengthen the level of patent protection in Japan and we will continue to work press Japan to implement these provisions.

Copyrights

Japan has made progress in combating computer software piracy in recent years, with the "piracy rate," as calculated by U.S. industry, falling in the past three years from roughly 50 percent (of software in use) to roughly 30 percent in 1997. While this latter number is closer to developed country norms, the United States believes that Japan should adopt measures to reduce the piracy rate further. A notable step toward creating an effective deterrent against piracy would be the amendment of Japan's Civil Procedures Act to award punitive damages rather than actual damages and to provide for more effective procedures for the collection of evidence. Additionally, in order to lead the private sector by example, we urge Japan to issue a policy statement clarifying Japan's commitment to use only legitimately produced and licensed software in its government's operations.

In March 1997, Japan amended its copyright law to protect sound recordings produced in the United States and other WTO countries within the past 50 years. This represented the resolution of the first intellectual property dispute settlement case at the WTO, which the United States initiated against Japan in 1996 after Japan failed to provide full "retroactive" protection to pre-existing sound recordings in accordance with the

TRIPs (Trade Related Aspects of Intellectual Property) Agreement. The United States expects similar treatment of piracy over digital networks, including digital music broadcasting services. Japan has agreed to the World Intellectual Property Organization (WIPO) Copyright Treaty and the Performances and Phonograms Treaty. When ratified, these agreements will provide new protection for producers and performers of material

transmitted over the Internet. The United States will be monitoring Japan's implementation of these agreements.

Trademarks

A number of revisions to Japan's Trademark Law came into force in 1997. The revisions were intended to accelerate the granting of trademark rights, strengthen protection of well-known marks, address problems related to unused trademarks, and simplify trademark registration procedures in order to bring Japan into compliance with the Trademark Law Treaty. These measures also increase penalties for trademark infringement. Regrettably, in spite of the existence of provisions in Japan's Unfair Competition law designed to afford greater protection to well-known marks, protection of such marks remains weak.

Further, the unjustifiably slow trademark registration process in Japan, which requires approximately 36 months versus 16-18 months in the United States, impose burdens on foreign mark holders who must register their marks in Japan before seeking enforcement. The United States urges Japan to shorten this registration periods to acceptable levels.

Trade Secrets

The United States remains concerned about Japan's inadequate protection of trade secrets. Although Japan amended it's Civil Procedures Act to improve the protection of trade secrets in Japanese courts by excluding court records containing trade secrets from public access, this legislation does not adequately address the problem. Because the Japanese Constitution prohibits closed trials, the owner of a trade secret seeking redress for misappropriation of that secret in a Japanese court is forced to disclose elements of the trade secret in seeking protection. Because of this, and the fact that court discussions of trade secrets remain open to the public with no attendant confidentiality obligation on either the parties or their attorneys, protection of trade secrets in Japan's courts will continue to be considerably weaker than in the courts of the United States and other developed countries. The United States considers this to be unacceptable and will press Japan to undertake further reform in this area.

Border Enforcement

The United States is also concerned with the non-transparent aspects of, and access to, Japan's border control measures. In general, we urge Japan to improve its Customs recordation and information submission procedures to make it easier for foreign rights holders to avail themselves of protection from Japan's Customs authorities. Further, insofar as Japan provides ex-officio border enforcement of trademarks and copyrights through the Japan Customs & Tariff Bureau (JCTB), efforts should be made to enhance such enforcement through aggressive interdiction of infringing articles. In addition, we are concerned by the 1997 Japan Supreme Court decision to allow parallel imports of patented products and will be monitoring JCTB's implementation of this policy.

SERVICES BARRIERS

Financial Services

Japanese financial markets have traditionally been both highly segmented and strictly regulated, and as such, have discouraged the introduction of innovative products where foreign firms may enjoy a competitive advantage

and otherwise restricted business opportunities for foreign firms. Some of the restrictions that have impeded access include the use of administrative guidance, existence of a *keiretsu* system (interlocking business relationships), lack of transparency, inadequate disclosure, the use of a positive list to define a security, and lengthy processing of applications for new products. Each of these restrictions has hindered the emergence of a fully competitive market for financial services in Japan.

With a view to eliminating or reducing these barriers, on February 13, 1995, the United States and Japan concluded a comprehensive financial services agreement, "Measures by the Government of Japan and the Government of the United States Regarding Financial Services." This agreement features an extensive package of market-opening actions in the key areas of asset management, corporate securities, and cross-border financial transactions.

In the two years since the agreement was signed, Japan has implemented the vast majority of the commitments made within the specified time frames. In some instances, the timetable for implementation was accelerated. In a few areas, Japan has taken or announced additional actions for future implementation to improve the liberalization of Japanese financial markets.

The United States is currently closely monitoring the agreement to ensure that implementation remains on schedule and to assess the impact of the actions undertaken using the quantitative and qualitative criteria included in the agreement. At the March and October 1997 reviews, the United States emphasized the need for further improvements in financial disclosure and transparency. Japan is a signatory to the December 1997 WTO Financial Services Agreement, wherein it bound many liberalization measures agreed to bilaterally. The WTO Financial Services Agreement entered into force on March 1, 1999.

In an announcement on November 11, 1996, then-Prime Minister Ryutaro Hashimoto committed Japan to conducting broad-based deregulation of Japan's financial sector, aimed at making Tokyo's financial markets comparable to those of New York and London by 2001. The Japanese Government's "Big Bang" financial reform plans involve such major changes as allowing mutual entry across financial sectors, tax changes, liberalization of commissions, liberalization of foreign exchange transactions, tightened disclosure rules, and further liberalization of asset management regulations. These changes could create important new business opportunities for U.S. financial services providers. Despite increased attention to financial sector stability issues in late 1997 following several prominent financial bankruptcies, the Japanese Government has thus far adhered to its reform schedule, with a few exceptions. The Japanese Government introduced financial liberalization legislation into the Diet in March 1998 and the United States will continue to watch developments closely.

Insurance

Japan is the world's second largest market for insurance with annual premium revenues of $329 billion in JFY 1997. Ministry of Finance (MOF) regulations, informal guidance, and non-transparent industry association activities all act to limit competition and market access in Japan’s insurance market. While foreign firms’ shares of other G-7 countries' domestic insurance markets range from 10 to 33 percent, their share of the Japanese market is only 3.8 percent. Foreign firms in JFY 1997 had less than two percent of the primary life insurance market and under three percent of the primary non-life market (mostly auto, fire and marine insurance). Together, these two primary sectors account for roughly 95 percent of Japan's overall insurance market. However, the important role of foreign firms in developing new products and sales channels in the remaining five percent market segment, the so-called *third sector,* is reflected in their greater than 40 percent

share of this sector.

On October 11, 1994, the United States and Japan concluded a bilateral insurance agreement under the U.S.-Japan Economic Framework. By the fall of 1995, however, it became apparent to the United States that Japan intended to allow its insurance subsidiaries to operate in the third sector in a manner contrary to key provisions of the 1994 agreement. Following a year of difficult negotiations, on December 24, 1996, the United States and Japan reached agreement on a package of "Supplementary Measures" which would significantly deregulate Japan's insurance market, while ensuring the avoidance of “radical change” in the third sector. The Administration is closely monitoring the implementation of both agreements to ensure that the anticipated increased market access for foreign firms materializes.

1994 Insurance Agreement: The October 1994 Insurance Agreement commits Japan to enhance regulatory transparency, strengthen antitrust enforcement, introduce a "notification system" for the approval of insurance rates and products, and undertake specific liberalization measures. MOF has, to varying degrees, implemented these provisions. The agreement also sets forth MOF’s intention to allow insurance brokers to operate in Japan. However, while Ministry has established the framework for a broker system, the continued inability to differentiate insurance product form and type has limited opportunities for brokers.

Among other things, the 1994 Agreement calls for five Japanese Government corporations with large annual insurance requirements to use fair, transparent, non-discriminatory, and competitive criteria in their yearly allocation of insurance premium shares. Implementation of this remains a key concern; only one of the covered government corporations (the Housing Loan Corporation) has disclosed its premium allocation criteria. For all five corporations, the foreign share of premiums remains negligible even relative to foreign insurers' small share of the private-sector Japanese insurance market.

The Agreement also called for Japanese and foreign insurers in Japan to complete, by March 1995, a study of the impact of *keiretsu* business relationships and case agents on insurance purchasing patterns in Japan, and for the Japan Fair Trade Commission (JFTC) to conduct its own insurance study. As of February 1998, the private sector study had essentially been abandoned due to the Japanese industry's unjustifiable refusal to either design or undertake a meaningful study. The JFTC announced in November 1997 that it had begun its own study and hoped to complete it by the end of 1998. The United States strongly believes that the JFTC should devote sufficient resources toward ensuring that large Japanese insurance firms discontinue their abuse of *keiretsu* relationships and refrain from the use of other business practices that impede competition.

Finally, the 1994 Agreement contains a provision related to "mutual entry" of life insurers into non-life markets and of non-life insurers into life insurance markets. Until the enactment of the Insurance Business Law (IBL) on April 1, 1996, life and non-life insurance firms were strictly prohibited from doing business in each other’s sectors. The new Insurance Business Law allows subsidiaries to engage in such activities. Under the 1994 Agreement, Japanese also agreed to avoid "radical change" in the third sector until foreign, as well as small and mid-sized Japanese insurers (market participants that have a greater dependence on the third sector markets), have been provided a reasonable period to compete in significantly deregulated primary life and non-life sectors.

1996 Insurance Agreement: The "Supplementary Measures" of December 1996 defined the scope and timing of primary sector deregulation to be undertaken by MOF. The agreement also defines the scope of business

activities of the Japanese insurance subsidiaries in the third sector consistent with the commitment to avoid radical change. In December 1997, Japan agreed to bind these commitments under the WTO Financial Services Agreement.

Under the 1996 Agreement, Japanese committed itself to approve, by September 1997, applications for automobile insurance containing differentiated rates based on a range of risk criteria, such as age, gender, driving history, geography, and vehicle usage. This commitment was implemented on schedule. Japan also committed itself to obtain Diet passage and implement legislation amending the Rating Organizations Law to eliminate the authority of ratings organizations to set industry-wide rates for

automobile and fire insurance. Such rating organizations, which are comprised of all non-life insurers, have traditionally operated as rate-setting cartels, exempt from the Antimonopoly Act.

Japan also implemented its commitment to expand the list of products to be included under the "notification system." This accelerated the introduction of innovative products, including several important liability lines. MOF has also reduced the threshold above which insurers will be permitted to offer flexible rates for commercial fire insurance from the 30 billion yen (contract value) at the time of the 1996 agreement to 20 billion yen in January 1997. This ceiling was further reduced to seven billion yen in April 1998.

With respect to the third sector, the 1996 Agreement commits the Japanese Government to prohibit or substantially limit Japanese insurers' new subsidiaries from marketing certain third sector products of particular importance to foreign insurers, such as cancer, hospitalization, and personal accident insurance, until foreign firms have had sufficient time to establish a presence in the deregulated primary sectors. The agreement stipulates that, should Japan fully implement all the primary sector deregulation measures contained in the 1996 Agreement by July 1998, a two-and-one-half year “clock” would begin regarding termination of the measures to avoid radical changed in the third sector.

In June 1998, the United States and Japan conducted a biannual review of Japan’s implementation of its commitments under the insurance agreements, including a review of its implementation of its 1996 obligations. During the review, the United States noted its serious concern with Japan’s implementation of its commitments to deregulate the primary sector. The United States concluded that Japan has not fully implemented its obligations with regard to reform of the non-life insurance rating organizations, which continue to engage in cartel-like actions, such as by imposing form and rate uniformity on consumers for products such as voluntary automobile insurance and fire insurance. Nor has Japan fully implemented its obligations to approve new products and rate applications within the standard 90-day processing period. Since all of the primary sector deregulation criteria had not yet been fulfilled, USTR announced on July 1, 1998, that the United States does not support the initiation of the two-and-one-half year clock regarding the third sector measures.

In addition to inadequate deregulation of the primary sector, the United States remains seriously concerned about several aspects of Japan’s administration of the insurance sector. Foreign firms have frequently encountered a lack of transparency, as exemplified by the establishment of insurance policyholder protection organizations in Japan in 1998. A similar lack of transparency was seen in the process to reform the rating organizations, revise rates for personal accident insurance, reallocate premiums of the Housing Loan Corporation among insurance providers, and in the approval process for new products and rates. In addition, the United States is extremely concerned with the diminution of the third sector safeguards caused by increased activity on the part of Japanese insurance firms and subsidiaries in this market segment. The United States continues to press these issues at and insists upon full and faithful implementation of the measures contained in each of the insurance agreements.

The Administration is prepared to utilize all of the tools at our disposal to ensure the full benefits to U.S. industry from our bilateral Insurance Agreement. With the entry into force of the WTO Financial Services Agreement on March 1, the United States now enjoys multilateral rights of enforcement under the WTO Dispute Settlement rules with respect to measures Japan has committed to take to deregulate and open its insurance

market. Of course, we continue to retain our rights under U.S. trade law to enforce our trade agreements.

Professional Services

The Administration continues to seek improved access for professional service providers in Japan, through (1) our bilateral Public Works Agreements for construction, architectural, and engineering services; (2) under the Enhanced Initiative on Deregulation for legal services; and (3) multilaterally in the WTO for accounting and auditing services.

The ability of foreign firms and individuals to provide professional services in Japan is hampered by a complex network of legal, regulatory and commercial practice barriers. U.S. professional services providers are highly competitive and the United States expects the export of such services to continue to grow in the future. These services are important, not only as U.S. exports in themselves, but as vehicles to facilitate access for U.S. exporters of other services and goods to the Japanese market. Moreover, U.S. services professionals often can contribute valuable expertise gained from operating widely in international markets and stimulate innovations for the economies in which they serve.

Through the WTO Working Party on Professional Services, WTO members are developing disciplines on the regulation of the accountancy sector to make it easier for accountants to provide their services on a cross-border basis or in other countries. The forthcoming GATS negotiations in 2000 also will offer an opportunity for liberalization of accountancy and other professional services.

Accounting and Auditing Services

U.S. providers of accounting and auditing services also face a series of regulatory and market access barriers in Japan which impede their ability to serve this important market. In Japan, regulated accounting services may be provided only by individuals qualified as Certified Public Accountants (CPA) under Japanese law, or by an Audit Corporation (composed of five or more partners who are Japanese CPAs). To become qualified as a CPA in Japan, a foreign accountant must pass a special examination for foreigners in order to obtain a professional certification. This examination was last offered in 1975. CPAs in Japan must also be registered as members of the Japanese Institute of Certified Public Accountants and pay membership fees.

Only individuals who are Japanese CPAs can establish, own, or serve as directors of Audit Corporations. An Audit Corporation may employ foreign CPAs as staff, but foreign CPAs are not allowed to conduct audit activities. Furthermore, an Audit Corporation may engage in a partnership/association relationship with foreign CPAs only if the partnership/association does not provide audit services. Audit Corporations are prohibited from providing tax-related services, although the same individual may perform both functions as long as totally separate offices are maintained. Establishment is required for Audit Corporations, but not for firms supplying accountancy services other than audits.

Branches and subsidiaries of foreign firms, however, are not authorized to provide regulated accounting services. Nor can a foreign firm practice under its internationally recognized name; its official firm name must be in Japanese and is subject to approval by the Japanese Institute of Certified Public Accountants.

Further, restrictions on marketing apply to all accountancy services provided by CPAs and audit corporations. The United States will continue to press Japan to open its market to American services.

Legal Services

Japan

U.S. lawyers have sought greater access to the Japanese legal services market and full freedom of association with Japanese lawyers since the 1970s. However, strong opposition from the *Nichibenren* (Japan Federation of Bar Associations) and a reluctant Japanese bureaucracy has largely thwarted this objective.

Since 1987, Japan has allowed foreign lawyers to establish offices and advise on matters concerning the law of their home jurisdictions in Japan, as foreign legal consultants (*gaikokuho-jimu-bengoshi*), subject to restrictions in the Special Measures Law Concerning the Handling of Legal Business by Foreign Lawyers (Law No. 66 of 1986, as amended) (Foreign Lawyers Law). Since this Law was enacted, Japan has liberalized several of the restrictions on foreign lawyers, including allowing foreign lawyers to represent parties in international arbitrations in Japan; reducing the experience required to register as a foreign legal consultant from five years to three years; allowing foreign lawyers to count the time spent practicing the law of the lawyer's home jurisdiction in a third country toward meeting the three-year experience requirement; liberalizing the ability of foreign legal consultants to practice third-country law with written advice from foreign lawyers qualified in that third country; and reducing the restrictions on the use of law firm names. However, Japan has adamantly refused to remove the most restrictive regulatory hurdle facing foreign lawyers in that country -- the ban on hiring or forming partnerships with Japanese lawyers (*bengoshi*) in Japan.

In an October 1998 submission to Japan under the Enhanced Initiative on Deregulation and Competition Policy, the United States stressed that it is essential that Japan's services infrastructure, especially its legal service providers, be capable of fulfilling the new opportunities created by the "Big Bang" and other market liberalizations and deregulation. In particular, both Japanese and foreign parties must be able to obtain fully integrated transnational legal services for domestic and cross-border transactions. To that end, the United States made the removal of the ban on partnerships and employment its top priority.

Rather than allow Japanese attorneys and foreign lawyers to form full partnerships, as is the common practice in most other countries, Japan in 1995 created, through an amendment to the Foreign Lawyers Law, an arrangement that is unique to Japan -- "specified joint enterprises" (*tokutei kyodo jigyo*) between Japanese attorneys and foreign lawyers. Foreign lawyers have repeatedly complained that this arrangement is not an adequate substitute for partnerships, despite an expansion of the scope of the enterprises in 1998, and only a handful of foreign firms have created joint enterprises. Even those that have formed joint enterprises have faced difficulties. The *Nichibenren* has harassed one joint enterprise because the *bengoshi* in the joint enterprise uses the name of the foreign law firm, despite the fact that it does not violate any law or regulation. The United States has raised its concerns with the *Nichibenren's* inappropriate use of its regulatory authority.

In its October 1998 submission, the United States also requested that full credit toward the three-year experience requirement to register as a foreign legal consultant be given a foreign lawyer for experience working for a foreign legal consultant in Japan, and not just the one year allowed under current practice. The United States also recommended that Japan increase the number of trainees admitted to the Japanese Supreme Court's Legal Research and Training Institute to no less than 1500 trainees annually as soon as possible, but no later than after April 1, 2000, and explore alternative ways of obtaining legal qualification

outside the Legal Research and Training Institute or a radical expansion of the Institute. In addition, the United States asked Japan to allow complete freedom of association among all types of legal professionals and to allow quasi-legal professionals to participate directly in foreign law firms.

The United States is continuing to press Japan to remove the ban on partnerships and employment, as well as other unnecessary and unreasonable restrictions on legal services in Japan, emphasizing that the Ministry of Justice and the *Nichibenren* must not be allowed to continue to thwart the development of a globally competitive legal services sector in Japan.

Telecommunications Services

The United States remains deeply concerned about Japan's excessive regulation of, and inadequate safeguards against anti-competitive activities committed by, incumbent telecommunications carriers, both of which undermine competition by raising costs and delaying entry or operations of new competitors.

Perhaps the most significant impediment is the high cost and onerous conditions associated with interconnecting to the Nippon Telegraph and Telephone Corporation (NTT) network. Judged by the book value of its telecommunications plant per minute of traffic, NTT's costs are about four times those of U.S. local exchange carriers -- costs that it imposes on competitors by embedding them in interconnection fees. In addition, NTT is permitted by the MPT to recover bloated costs for new services such as ISDN, by recovering these inefficient investments through interconnection rates, while subsidizing this service for its retail customers. This classic "price squeeze' behavior–forcing its competitors to lose money if they are to price a competing service at or below NTT's retail rates -- ensures that NTT's monopoly persists. As interconnection is a critical element in permitting competition, the United States strongly urges Japan to set interconnection rates as close as possible to competitive market prices in order to prevent NTT from imposing excessive costs on competitors. This also highlights the inherent contradiction of Japan's regulatory regime in that MPT is simultaneously engaged in industrial policy -- promotion of ISDN -- while trying to regulate a dominant carrier. The MPT has distorted the market in two ways by forcing NTT to subsidize development of a questionable service and permitting NTT to pass on uneconomic interconnection rates to its competitors.

The arbitrary and anti-competitive result of the current interconnection regime is demonstrated in interconnection rates for so-called tandem-level switching, which contains a rate element (transporting calls a short distance in the local market) which is twenty-five times comparable rates in the united States. It appears that NTT engages in such manipulation since its arbitrary decisions on how to allocate costs are not subject to audit.

Japan has committed itself to introduce a pro-competitive methodology for calculating NTT's interconnection charges which will address these issues in 2000 and to reduce rates before then. However, NTT's revised interconnection tariff applicable to JFY 1998 contained only minimal reductions in interconnection rates and maintained other deficiencies, including an anti-competitive rate structure where retail rates are consistently priced below interconnection rates. NTT also failed to provide cost-based access to ducts, conduits and dedicated transport throughout its network, and failed to guarantee timely interconnection. The United States has also expressed concern about high charges and unfair conditions for interconnection imposed by NTT DoCoMo, the dominant wireless carrier, and has asked Japan to curb these abuses by imposing stricter interconnection obligations required of "designated facilities." Given that wireless traffic is rapidly approaching wireline traffic in importance in Japan, the

Japanese Government's willingness to ensure fair competition in this area will be essential in creating a competitive environment in the Japanese telecommunications sector.

The United States has also raised concerns about the inadequacy of Japanese Government regulations to

ensure fair access for new competitors to the poles, ducts, conduits and other rights of way they will need to construct their networks in Japan. These scarce resources are often controlled by entities such as NTT and utility companies that have a strong incentive to delay market entry and raise costs for new telecommunications competitors. As a result, new entrants in Japan's telecommunications sector complain that it is difficult, costly, and time-consuming for them to build their own networks–significantly reducing their ability to compete. The United States has proposed that Japan establish pro-competitive rules to ensure non-discriminatory, transparent, timely, and cost-based access for both telecommunications carriers and cable TV operators. While appreciating the efforts of a recent Japanese Government study group to improve the current situation by advocating that entities controlling rights of way voluntarily publish application procedures to increase transparency, the United States Government believes that these measures are inadequate to ensure that access is available to new competitors on a timely and reasonable basis.

Moreover, U.S. industry wants assurances that users of telecommunications services can access the services of new entrants as easily as existing carriers. For example, current customers wanting to use KDD to place an international call must dial a three-digit access code, while access codes for other international carriers are four or six digits. The United States was encouraged by a recent MPT study group report that called for the introduction of a carrier pre-selection system, where users would choose their carriers up-front, rather than relying on access codes. However, we continue to have concerns about the timing and costs of the proposed system.

The requirement that new entrants negotiate with over 50 individual interconnection agreements with different telecommunications carriers to begin service where users can terminate calls anywhere in Japan also serves to delays entry and raises costs for new competitors. The United States believes that Japan should allow a clearinghouse system, where a carrier can pass traffic to an "intermediary" carrier for termination on a variety of different networks. This would obviate the need for individual agreements with each terminating carrier. A MPT study group is expected to issue a report on this issue by the end of JFY 1998 (March 31, 1999).

Further, new competitors are also seriously impeded by MPT restrictions on the leasing of lines by facility-based carriers and the ownership of lines by non-facility based carriers. Companies wishing to develop a network using a combination of owned and leased elements -- often the most efficient way to build a network -- are burdened with having to set up and manage separate subsidiaries, which is an inefficient structure. The Japanese Government places restrictions on the use of new technologies, which utilize power mains to transmit communications signals for a range of innovative automation and control services, even though this method is widely used in the United States, Europe and Canada. The United States urges Japan to remove these restrictions as soon as possible to allow the development of these new technologies.

As a general regulatory policy issue, the United States is concerned that there is no system for differentiating the treatment of dominant carriers from non-dominant carriers in Japan's regulatory policies. In the U.S. view, competition is best stimulated by focusing regulatory oversight on "dominant carriers" -- carriers in a position to hold consumers and competitors "hostage" through control over services or underlying facilities -- while allowing carriers without such market power to operate with

minimal constraint to speeds the introduction of new products and services. Currently in Japan, there is a dramatic over-regulation of non-dominant carriers and an insufficient regulation of dominant carriers.

The United States is also concerned with possible anticompetitive implications of aspects of NTT's planned

1999 restructuring; continued foreign investment restrictions in NTT, cable TV businesses, and direct-to-home satellite services; timing and costs of implementing a number portability system; restrictions on the structure and operations of direct-to-home satellite broadcasting services; the introduction of third generation wireless standards in Japan; and burdensome licensing procedures.

INVESTMENT BARRIERS

Japan's stock of inward foreign direct investment (FDI), relative to the overall size of its economy, appears minuscule in comparison to that of other advanced industrialized countries. In 1997, for example, the value of Japan's stock of inward FDI totaled only about 0.8 percent of the nation's 1997 gross domestic product, as compared to roughly 8 percent for the United States. Japan's outward investment flows, on the other hand, dwarf investment into Japan: the ratio of outward-to-inward FDI averaged 11-to-1 between 1990 and 1996. In 1997, Japanese overseas FDI was $50 billion; Japan's inward FDI was only $5 billion.

Acknowledging that Japan's inward investment lags far behind that of other industrialized economies, Japan has taken some limited actions to address the problem, aimed at making the environment for foreign investment in Japan more attractive. In 1994, Japan established the Japan Investment Council (JIC), chaired by the Prime Minister and charged with: promoting measures to improve Japan's investment climate; coordinating policies of ministries and agencies concerned with investment; and disseminating information on investment-promotion measures. In 1995, the JIC released a statement that encouraged FDI and listed a few useful policy measures, and in 1996 the JIC issued a policy statement and action plan aimed at increased inward investment through mergers and acquisitions. The JIC has also prepared less formal on local government investment promotion efforts and labor market mobility.

Although most direct legal restrictions on foreign direct investment have been eliminated, bureaucratic obstacles remain, including the occasional discriminatory use of bureaucratic discretion. While Japan's foreign exchange laws currently require only ex-post notification of planned investment in most cases, a number of sectors (e.g. agriculture, mining, forestry, fishing) still require prior notification to government ministries. More than government-related obstacles, however, Japan's low level of inward FDI flows reflects the impact of exclusionary business practices and high market entry costs.

Difficulty in acquiring existing Japanese firms -- as well as doubts about whether such firms, once acquired, can continue normal business patterns with other Japanese companies -- make investment access through mergers and acquisitions more difficult in Japan than in other countries. Extensive cross-shareholding among allied companies and difficulties foreign firms encounter in hiring employees also helps inhibit direct foreign investment.

Investment Arrangement: In July 1995, the U.S. and Japan concluded an arrangement entitled "Policies and Measures Regarding Inward Direct Investment and Buyer-Supplier Relationships" that lays out the inward FDI promotion policies instituted by the Japanese Government during the course of the Framework Agreement investment negotiations. The Arrangement commits Japan to expand efforts to inform foreign firms about FDI-related financial and tax incentives, and to broaden lending and eligibility criteria under these programs; make low interest loans and tax incentives under the 1992 "Inward Investment Law" available to foreign investors; propose measures to improve the climate for foreign

participation in mergers and acquisitions; and strengthen the FDI promotion roles of the Japan Investment Council, Office of the Trade Ombudsman, JETRO, and the Foreign Investment in Japan Development Corporation.

The "Inward Investment Law" has been extended from May 1996 to May 2006. In addition, the Ministry of International Trade and Industry has lowered the interest rate charged by the Japan Development Bank (JDB) to foreign investor in high-technology projects. In April 1996, foreign firms' eligibility for tax incentives was extended from the first five years to the first eight years of operation of a foreign firm in Japan. Looked at in their totality, however, Japan's FDI promotion policies are mostly appendages to domestic-oriented investment-promotion programs, and do not appear significant enough to immediately overcome the continuing fact of low foreign investment levels in Japan.

Investment Talks: After the signing of the Investment Arrangement, the bilateral discussions of the Investment Working Group under the Framework Agreement have focused more broadly on needed changes in the basic operating rules of Japanese markets, in order to encourage policy changes that will help improve Japan's overall environment for foreign (and domestic) investment. More specifically, through these talks, the United States has urged Japan to consider measures that will assist with three key aspects of improving Japan's direct investment environment:

- Developing a more active and efficient market for mergers and acquisitions, in order to enhance the productivity of capital in Japan;
- Improving land market liquidity and foreign investors' access to land; and
- Increasing the flexibility of Japan's labor markets.

In July 1998, the Investment Working Group agreed to compile a follow-up report to the 1995 Investment Arrangement, which will focus on needed policy changes in these three areas. As part of that process, in October 1998 the U.S. Government offered specific proposals for areas where policy changes appear most likely to lead to significant improvement in Japan's investment environment.

In the area of mergers and acquisitions (M&A), these proposals included allowing consolidated taxation in order to spur investment by lowering the post-tax cost to a parent firm of investing in new risk ventures; taking steps to unwind extensive cross-shareholding (*mochiai*) in Japan, which greatly complicates market-based merger and acquisition (M&A) transactions; improving corporate governance practices in order to mitigate senior management emphasis on firm loyalty over shareholder return, which can lead to premature rejection of M&A offers; continuing with financial market deregulation, including allowing stock-for-stock transactions and easing stock market listing requirements; improving financial data disclosure to assist firms interested in pursuing M&A relationships with other firms; increasing the availability of M&A-related services, including further easing of restrictions governing the accounting and legal professions; and introducing smoother and more flexible bankruptcy procedures to make it easier for a corporation and its assets to be acquired or merged in a "rescue" format.

In the area of land and real estate transactions, the proposals focused on improving land market liquidity, and included undertaking additional land tax relief measures and steps to further shift the burden of land taxation from acquisition taxes to holding taxes; easing regulations on developing property in central urban districts as well as relaxing restrictions on the conversion of agricultural land; changing leasing rules to allow new investors to make flexible use of acquired property; making systematic disclosure of information on real estate transactions; and making changes to the Special Purpose Corporation (SPC) Law and other related regulations to facilitate the creation of real estate investment trusts (REITs).

Finally, the U.S. Government proposals concerning Japan's labor markets focused on improving labor

mobility, and included introducing defined contribution pension plans as a useful way to improve pension portability; deregulating fee-charging employment agencies in order to assist foreign investors in locating needed local talent; liberalizing Japan's labor dispatching business in order to help new investors find workers and cut costs, as well as help unemployed workers find work; and easing excessively tight regulations concerning work rules, as well as other bureaucratic procedures which unnecessarily raise costs and lower the efficiency of corporate operations.

ANTICOMPETITIVE PRACTICES

Anticompetitive practices are a crosscutting issue in U.S.-Japan trade relations. In addition to the discussion in this section, there is further discussion related to anticompetitive practices and Antimonopoly Law (AML) enforcement in other sections: the Enhanced Initiative on Deregulation and Competition Policy, Insurance, Flat Glass, Paper and Paperboard, and Consumer Photographic Film and Paper.

Exclusionary Business Practices: American firms trying to enter or participate in the Japanese market face a host of exclusionary Japanese business practices that block market access opportunities. These include:

- Anti-competitive private practices -- such as bid-rigging, price-fixing, and exclusive dealing arrangements -- that violate the Antimonopoly Act but often go unpunished;

- Corporate alliances and exclusive buyer-supplier networks, often involving companies belonging to the same business grouping *keiretsu*, that work to protect "market stability" (e.g., stable market shares and profit margins);

- Questionable corporate practices that inhibit foreign direct investment and foreign acquisitions of Japanese firms (e.g., non-transparent accounting and financial disclosure, cross-holding of shares among *keiretsu* member firms, low percentage of publicly traded common stock relative to total capital in many companies, and restrictions on foreigners serving on corporate boards);

- Industry associations and other business organizations that develop and enforce industry-specific rules limiting or regulating, among other things, fees, commissions, rebates, advertising, and labeling for the purpose of maintaining "orderly competition" among their members, and often among non-members.

Exclusionary Japanese business practices exact a heavy toll on the Japanese economy. For example, many products and services cost substantially more, often two to three times more, in Tokyo than in other international cities. By constraining market mechanisms, such exclusionary business practices reduce the choices available to businesses and consumers, and raise the cost of goods and services, as is reflected in Japan's large internal-external price gap. In addition, by discouraging competitors who seek to break into Japan's market with innovative products and services, the practices impede the development of new domestic industries and technologies (e.g., in software, multimedia, and telecommunications). Moreover, such practices discourage potential foreign investors, whose market presence and technological innovation would stimulate the economy and provide critical channels for exports and sales by foreign firms.

Japan Fair Trade Commission's Enforcement Record: A key reason for the prevalence of anticompetitive business practices is the historically weak antitrust enforcement record of the Japan Fair Trade Commission (JFTC). The JFTC routinely faces domestic criticism for its lack of bureaucratic clout and reluctance to exercise its enforcement powers aggressively. Although there have been improvements in recent years due

to sustained U.S. efforts under the Structural Impediments Initiative, the U.S.-Japan Framework Agreement, the U.S.-Japan Enhanced Initiative on Deregulation and Competition Policy, and annual bilateral antitrust consultations, which have all combined to help the JFTC muster domestic support for its gradual strengthening, the JFTC's enforcement efforts fall short of those needed to ensure that Japanese markets are open to competition from U.S. and other foreign companies.

The JFTC's ability to enforce Japan's AML is hindered by its historically weak stature among Japanese ministries, shortage of personnel, inadequate investigatory powers, and perceived lack of autonomy. The JFTC was "upgraded" in 1996 to allow the formation of an administrative general affairs bureau, an economic bureau, investigations bureau, and a new special investigation division to handle major cases. Previously, the JFTC was organized by departments, which relegated JFTC officials to a lower status relative to ministry officials. However, the JFTC failed to gain approval for the creation of a competition policy bureau and did not achieve the substantial gains it needs in enforcement personnel. In Japan Fiscal Year (JFY) 1998, JFTC staff increased by only 10 members from the levels of the previous year to a total of 557, of which 254 (7 more than JFY 1997) are engaged in investigation-related work. There are 59 investigators (an increase of four) in the special investigations department.

In JFY 1999, the Government of Japan plans to increase the JFTC's budget by 2.8 percent and increase its personnel by nine, of which seven will be assigned to the investigation bureau. Still, these increases remain too small for the JFTC to adequately enforce competition laws and policies. This is especially true given the potential effects on the Japanese competitive environment of the recent liberalization of holding companies, the increase in mergers (up 10.9 percent in 1998), imminent narrowing or abolishment of many AML exemptions, and deregulation. In its October 1998 submission to the Japanese Government under the Enhanced Initiative, the United States asked that it increase the JFTC staff by 25 persons each year over the next five years. Further, the United States proposed that the Japanese Government increase the JFTC's budgetary resources by 5 percent annually over the next five years.

The JFTC's public image as an effective enforcer of the AML lags behind recent improvements in its stature and enforcement performance. For example, after maintaining surcharge orders for cartel practices at very low levels during the 1980s, the JFTC has steadily increased its penalties since 1990. In 1997 the JFTC took legal measures in 27 cases -- 17 of these cases were so-called "hard core cartel" cases which resulted in $47.3 million in administrative surcharges. However, the JFTC rarely recommends criminally prosecuting Antimonopoly Law violators -- since 1990 the JFTC has filed only five "criminal accusations" with the Ministry of Justice for criminal prosecution. Similarly, there has never been imprisonment of a corporate executive for violating the AML. Although the JFTC is not alone among competition agencies in the world that rely heavily on administrative actions instead of criminal penalties, the JFTC's infrequent use of the AML's criminal provisions undermines its deterrence of cartel behavior.

In September 1998, the Chairman of the JFTC in a speech to a group in Osaka recognized that the number of criminal accusations filed by the JFTC to the Ministry of Justice has been few. He pointed to two reasons for the paucity of criminal accusations. First, the JFTC does not have the types of investigatory powers enjoyed by other Japanese criminal investigating authorities. This weakness makes it difficult for the JFTC to gather enough evidence to support filing a criminal accusation with the Ministry of Justice, which requires a great amount of evidence before it will accept a criminal accusation. Second, in addition to the already high evidentiary burden placed upon the JFTC by the Ministry of Justice, an extraordinary

procedural rule (nonexistent in any other area of Japanese law) further intensifies the burden; that is, if the Ministry of Justice decides after receiving a criminal accusation that there is not enough evidence to warrant prosecution, it must report its decision of nonprosecution to the Prime Minister's Office. This extraordinary procedural requirement makes Ministry of Justice prosecutors demand that the JFTC support its criminal

accusation with highly compelling evidence to ensure that they will never have to make a report of nonprosecution to the Prime Minister's Office. Due to these types of weaknesses and encumbrances, criminal prosecution of executives and firms for cartel-like behavior remains the exception rather than the rule in Japan.

Although the JFTC is nominally an "independent" commission with "independent" enforcement authority, its leaders are often drawn from other ministries, raising doubts about the commission's autonomy. Indeed, the JFTC commissioners always include former senior officials from trade-related ministries, notably, the Ministries of Finance, International Trade and Industry, and Foreign Affairs. Historically, the vast majority of JFTC chairmen have been former top career officials of the powerful Ministry of Finance. Japanese economic observers agree that as long as these "ex" ministry officials are involved in JFTC decision-making, the Commission cannot be considered truly "independent." The current JFTC Chairman is a former public prosecutor and ex-official (Ministry of Justice) who has raised some public expectations of a more activist JFTC enforcement role. The United States has yet to see whether a 1996 amendment raising the mandatory retirement age of the JFTC chairman from 65 to 70 will facilitate the candidacy of non-bureaucrats for the top JFTC job, and thus questions about the JFTC's independence remain.

Laws Distorting Competition

The JFTC administers or helps administer a number of laws and regulations that distort competition and often have anticompetitive effects.

Law Against Unjustified Premiums and Misleading Representations: The JFTC imposes unrealistic limits on the use of premium offers (prizes), and thereby discourages even legitimate cash lotteries and product giveaways used in sales promotions. Foreign newcomers, who depend on innovative sales techniques to market their company names and products, are severely impaired by the JFTC's restrictions on premiums. In addition, although the law aims to deter misleading or fraudulent advertising and labeling (itself a worthy policy), the JFTC allows "fair trade associations" (essentially, private trade associations) to set their own promotion, advertising and labeling standards through self-imposed "fair competition codes." This creates difficulties, especially for newcomers who are unfamiliar with local guidelines. Trade associations can, and often do, use the cover of these codes to set additional standards that are stricter than the JFTC regulations under the Premiums Law.

As of January 1999, there are 48 JFTC-authorized private premium codes. In April 1996, the JFTC incrementally liberalized its rules on premiums and other sales promotions, for example, by raising the maximum value of "open" cash lotteries (not requiring a purchase) to ten million yen; repealing restrictions on premiums offered by department stores; and eliminating the 50,000 yen ceiling on consumer premiums (while retaining price caps as a percentage of the transaction value). Moreover, over the last two years the JFTC abolished 24 of 29 industry-specific premium limits. The five industries that remain subject to stricter rules are real estate, household electrical appliances, newspapers, magazines, and hospital management. However, the JFTC changes fall short of the dramatic liberalization measures requested by the U.S. Government in Framework discussions and under the Enhanced Initiative for Deregulation and Competition Policy.

Resale Price Maintenance: In April 1997, the Japanese Government abolished all product exemptions of the AML, with the prominent exception of copyrighted products (books, magazines, newspapers, and CDs). There is no reason that retail price maintenance should be treated any differently under the AML than any other practice. The JFTC has been considering limiting or eliminating the retail price maintenance

exemption for copyrighted products. On January 13, 1998, a study group to the JFTC recommended a phased elimination of this exemption, and the JFTC announced its decision on March 31, 1998, which stated:

- Even though the resale price maintenance exemption should be abolished from the viewpoint of competition policy, the issue should be further examined by carefully considering cultural impacts and influences;

- Until the final decision is made, the exemption is limitedly applied to books, magazines, newspapers, music CDS, cassettes and records; and

- The relevant industries should therefore make determined efforts to reduce the adverse effects of this system.

Business Reform Law: On April 1, 1995, Japan implemented the Law to Promote Business Reform for Specified Industries (Business Reform Law) which authorizes MITI to implement industrial policy measures in designated industries. The Business Reform Law expires on June 30, 2002 and the United States will strongly object to any efforts to extend it. Under this law, in exchange for a firm in a designated industry adopting a MITI-approved business reform plan, the Ministry will provide it with preferential measures, such as special depreciation allowances and company registration tax reductions. This type of preferential treatment distorts the market mechanism and runs counter to Japan's efforts to liberalize its economy through deregulation. Moreover, several targeted sectors include leading Japanese industries, such as automobiles and telecommunications, which are hardly in need of preferential treatment.

Additionally, under Article 7 of the Business Reform Law, when firms in the same industry jointly submit business reform proposals, the reviewing Minister may consult with the JFTC regarding the joint applications. The JFTC may provide legal analysis to the Minister, and if an Antimonopoly Law problem exists, the Minister will have an opportunity to further consult with the JFTC. In its October 1998 deregulation submission, the United States urged Japan to abolish Article 7 of the Business Reform Law because it inappropriately diminishes the independence of the JFTC by setting up a consultation mechanism which may be construed as an Antimonopoly Law exemption.

Cartel Exemptions: On February 16, 1999, the Cabinet announced its intention to introduce legislation which will eliminate the exemptions for Depression Cartels, Rationalization Cartels, and others. Under the Enhanced Initiative, Japan committed itself to submit legislation by March 1999 to implement these changes.

Relationship between Government and Industry

Japanese regulators view their role, not simply as neutral arbiters of a legal rule-based system, but as active players in guiding the respective industries under their purview. The close government-industry relationship in Japan often works to the disadvantage of foreign firms trying to enter or participate in the Japanese market because the relationship favors domestic firms. Several aspects of the relationship are of particular concern.

Private Regulations: The United States has emphasized that as Japan removes and relaxes regulations, it is essential that industry associations and other private sector organizations are not allowed to substitute private sector regulations (so-called "*min-min kisei"*) in their place. Private regulations, including rules on market entry and business operations, approvals, standards, qualifications, inspections, examinations and

certification systems can adversely affect business activities. One of the particular concerns that the United States has raised under the Enhanced Initiative is the formal or informal delegation by the Japanese Government of governmental or public policy functions, such as industry standard development, product certifications and entry authorizations, to industry associations and other business-related organizations. Unfortunately, these groups are generally not under an obligation to conduct their deliberations in an open, transparent and non-discriminatory manner or to include foreign firms in their discussions. The United States has asked Japan to refrain from such delegations of government or public policy functions. If there is a demonstrated need for such a delegation of authority, the United States wants to ensure that it is carried out by the associations in an open, transparent and non-discriminatory manner and does not restrict the business activities of firms that are not members of the association.

Informal Management of Industry: Business in Japan is more heavily regulated than in the United States. Much regulation takes place privately and informally through a variety of means: cooperative consultations between a ministry or agency and the affected industry, industry association or other business-related organization; the issuance of "administrative guidance" to companies; and the placement of retired bureaucrats in companies and industry associations through a practice called *amakudari* (literally, “descent from heaven”).

ELECTRONIC COMMERCE

As the second largest economy in the world and the nation with the second largest electronics industry in the world after the United States, Japan is an important market for electronic commerce and an important player in international discussions regarding the regulatory framework for global electronic commerce and the Internet. The United States is pleased to see that Japan has, in its policy statements and its regulatory actions to date, endorsed an open, private sector-led and minimally regulated environment for the Internet and electronic commerce.

Following the announcement by President Clinton of the “Framework for Global Electronic Commerce” policy paper in July 1997, the United States entered into discussions with the Japanese Government on the range of e-commerce issues included in that paper. In May 1998, at the Birmingham Summit, President Clinton and then-Prime Minister Hashimoto announced the “U.S.-Japan Joint Statement on Electronic Commerce.” In the Joint Statement, the U.S. and Japan agreed that (1) the private sector should lead in the development of electronic commerce; (2) governments should encourage industry self-regulation; (3) government regulation, where necessary, should be minimal, transparent, and predictable; and (4) regulatory frameworks for electronic commerce should be developed on a global basis, rather than nation by nation.

With respect to several specific policy issues, the Joint Statement noted that: (1) privacy, and the protection of confidential consumer data, should be protected through industry self-regulation, with industries responsible for drafting guidelines, enforcement mechanisms, and recourse methodologies; (2) tariffs should not be imposed on electronic commerce, and the United States and Japan will work toward a global understanding in the WTO to preserve a duty-free environment for electronic transmissions; (3) content should be transmitted freely across national borders in response to a user’s request; (4) electronic authentication/electronic signatures will be necessary to enforce contracts on the Internet, (5) the U.S. and Japan support the development of a variety of implementation methods and technologies, led by the private sector; and (6) tax treatment of electronic commerce should be addressed through the on-going discussions at the Organization for Economic Cooperation and Development (OECD).

These principles were echoed in a June 1998 policy paper issued by the Advanced Information and Telecommunications Society Promotion Headquarters, an advisory group to the Prime Minister. The United States will continue to work with Japan on these and other electronic commerce issues (e.g., intellectual property protection on the Internet, consumer protection, and electronic payment systems) and will continue to monitor the development of electronic commerce and the Internet in Japan to ensure that Japanese Government-funded test-bed projects for electronic commerce continue to be fully open to participation by U.S. companies and that standards and technologies for electronic commerce and the Internet remain open and internationally interoperable. The United States will also monitor actions by regulators such as the Ministry of Posts and Telecommunications (e.g. regarding licensing requirements and restrictions on new standards and technologies) to ensure that the most liberal regime possible is promoted.

OTHER BARRIERS

Aerospace

Japan is the largest foreign market for U.S. aircraft and aerospace products, and many Japanese firms have entered into long-term and productive relationships with American aerospace firms. Nonetheless, the United States is continuing to closely monitor several aspects of U.S.-Japan aerospace trade.

Among these are the Japan Defense Agency's general preference for licensing foreign technology for production in Japan, which has resulted in lower U.S. defense aerospace exports than would occur in a more market-driven environment. With respect to commercial aerospace, the United States is monitoring MITI's active role in supporting the domestic aerospace industry, funding feasibility studies for new projects and technologies, and the important role it plays in the apportioning of work among the major Japanese aerospace companies. We also are closely watching the role that the Japan Defense Agency plays in the development of defense aerospace projects, which have resulted in a significant transfer of U.S. aerospace technology to Japan and positioned Japan to become a major supplier of parts and components to foreign aircraft assemblers.

With respect to space systems, the United States is monitoring Japan’s efforts to develop indigenous systems, which may limit the procurement of proven U.S. technology and products. The United States will continue to push for greater access to areas where Japan’s preference for the development of domestic space technologies has been most pronounced, including: space recorders and scientific instruments; sensors for earth resources and astronomical research satellites; and software and ground-based data processing, storage and distribution systems.

The United States will continue to monitor developments to ensure that the Japanese aerospace market remains open and that Japanese Government actions do not discriminate against U.S. aerospace companies.

Autos and Auto Parts

The 1995 U.S.-Japan Automotive Agreement seeks to eliminate market access barriers and significantly expand sales opportunities in this sector. Under the agreement, Japan committed to improve access for foreign vehicle manufacturers, expand opportunities for U.S. original equipment parts manufacturers in Japan and the United States, and eliminate regulations that restrict access for U.S. and other competitive foreign automotive parts suppliers to the Japanese repair market. The agreement includes 17 objective criteria, by which the United States and Japan are to evaluate progress. Coincident with the conclusion of

the agreement, the five major Japanese auto manufacturers announced plans to increase purchases of foreign auto parts in Japan, and to expand production of vehicles and major components in the United States.

The Administration attaches high priority to vigorous implementation of the Automotive Agreement because of the importance of this sector to the U.S. economy. To monitor implementation and assess progress achieved under the agreement, an Interagency Enforcement Team, headed by the Office of the U.S. Trade Representative and the Department of Commerce, was established. This team prepares a semi-annual report evaluating progress since the agreement was reached. The fifth and most recent of these reports was issued in August 1998.

The United States remains concerned about the lack of progress toward achieving the agreement's key objectives, although results in some areas have been satisfactory. The United States conveyed specific concerns to Japan during the third annual review of the Automotive Agreement held in San Francisco in October 1998, and its concerns were echoed by representatives from the European Union, Canada, and Australia. The United States called upon Japan to take additional, concrete actions to ensure continuing improvements in market access and sales opportunities in the Japanese automotive market and urged immediate, substantial deregulatory and market-opening action to foster domestic demand-led growth. The U.S. Government followed up on these requests during informal consultations held in February 1999.

Vehicles: Sales in Japan of motor vehicles produced by the "Big Three" U.S. automakers in North America continued to decline, dropping 34.5 percent in 1998, compared to a decline of 20 percent in 1997. This drop well exceeded the 13 percent contraction of the overall Japanese auto market. Moreover, it occurred despite the Big Three's maintenance of competitive prices in the face of a weak yen.

Foreign access to Japan's automotive distribution network remains a problem. U.S. auto companies continue to seek high-quality, high-volume dealerships, and are working to strengthen their dealership networks. However, some Japanese dealers continue to have reservations about carrying competing foreign vehicles for fear that doing so would compromise their relationships with Japanese manufacturers and thereby jeopardize their business, despite Japanese Government steps to ensure that dealers understand that they are free to carry the products of competing manufacturers. While the Big Three U.S. automakers have added a total of 192 new outlets through direct franchise agreements with Japanese dealers since 1995, the number of additional new dealerships diminishing markedly over the past year.

Auto Parts: Exports of U.S.-made auto parts to Japan fell 7.5 percent in 1998, compared with an average 20 percent annual increase between 1993-97. This is the first decline since the conclusion of the agreement in 1995. Sales of original equipment auto parts to Japan remain low, and, concerns are mounting that recent declines in orders for original equipment parts will push these numbers down further still. Moreover, despite large percentage increases, actual U.S. after market parts sales to Japanese auto companies in the U.S. and Japanese auto companies in Japan remain low.

Japanese auto manufacturers have made considerable progress in implementing the voluntary global business plans they announced when the Automotive Agreement was signed. They have boosted production of passenger cars, light trucks, and a range of components, including engines and transmissions, in the United States. These increases have led to new sales opportunities for U.S. suppliers, and increased employment opportunities for U.S. workers.

Recent trends in bilateral automotive trade have underscored U.S. Government concerns about progress

under the Agreement. To address these concerns, the United States has strongly urged Japan to undertake additional market opening and deregulatory measures in this sector. At the annual review of the Automotive Agreement in October 1998, the United States presented 11 new concrete proposals for achieving further progress. To strengthen dealerships, which are key channels to the automotive distribution system, the United States proposed that Japan streamline new vehicle registration in Japan and that it consider ways to tailor incentives offered by the Ministry of International Trade and Industry, the Japan Export-Import Bank, and the Japan Development Bank to make them more useful to foreign companies. The United States requested that Japan work with the United States to improve the efficacy of its import promotion programs. In addition, while noting that it shares the Japanese Government's environmental objectives in developing new fuel economy regulations – which Japan plans to adopt this year – the U.S. Government requested that Japan ensure that the new standards be transparent and non-discriminatory.

Among the other proposals presented by the U.S. Government were (1) eliminating unnecessary requirements of the "*shaken*" inspection and repair systems to allow more garages, particularly independent garages (which are more inclined to use foreign auto parts)--to conduct inspections and repairs; (2) removing brakes and other components from the disassembly repair regulations (critical parts list); (3) allowing mechanics working in specialized garages to be certified in the types of repair conducted by that garage (to allow a progression of expertise and skill in mechanic certification), which would encourage the development of specialized garages, which were created under the agreement to encourage the development of an independent repair market; (4) reviewing policies regarding development and implementation of regulations to prevent Japanese trade associations and other vested interests from undermining the intended impact of deregulation; and (5) encouraging the Japanese automakers to provide to the U.S. Government with updated business plans.

The United States also requested that Japan continue to support JETRO programs aimed at promoting imports of foreign auto parts and that the Ministry of Transport not reinstitute its proposal for establishing an auto parts recall system. In addition, the U.S. Government requested that Japan sign the 1998 Global Agreement for the harmonization of technical regulations regarding motor vehicle safety, emissions, energy conservation, and theft prevention.

Informal consultations on these automotive issues were held in Tokyo in February 1999. During these consultations, Japan informed that United States that it planned to take action to streamline the new vehicle registration system this year, including establishment of a "one stop shop" for all new vehicle registration procedures by 2000. The Japanese Government also agreed to consult with individual U.S. and other foreign automakers on ways to adapt the financial incentive programs it has established to make them more valuable to these companies and with the U.S. Government (and the EU) on the new fuel economy standards. On auto parts, the Japanese Government agreed to study jointly with the United States areas for possible deregulation of the *shaken* system and informed the United States of its intention to further liberalize the certified mechanics system by creating another class of special certified mechanics, a move taken in response to U.S. requests. Japan said it does not plan to go forward with an auto parts recall system proposal this year but that it is prepared to sign the 1998 Global Agreement on harmonization if vehicle standards, although the process may be delayed if it is determined that legislative approval is required.

The United States will continue to closely monitor Japan's implementation of the Automotive Agreement and to press Japan at all levels to take concrete steps to achieve additional progress under the agreement.

Civil Aviation

On March 14, 1998, Transportation Secretary Slater and then-Japanese Transport Minister Fujii signed a Memorandum of Understanding (MOU) which promises to significantly expand civil air services between the United States and Japan while setting the stage for further liberalization in the future. The agreement removed all restrictions on the U.S.-Japan services of so-called "incumbent" carriers -- United Airlines, Northwest Airlines, and Federal Express for the U.S. side – that operate from any U.S. gateway point to any point in Japan and beyond Japan to third countries without limitation on the number of flights. It also allowed the United States to designate two additional passenger carriers to serve Japan, one immediately (Trans World Airlines) and another airline in two years.

Moreover, U.S. "non-incumbent" combination carriers now serving Japan -- American Airlines, Delta Air Lines and Continental Airlines along with the two newcomers -- can add up to 90 more weekly round-trip flights to their current total of 46, nearly tripling access to Japan's huge aviation market. (Combination carriers carry both passengers and cargo.) U.S. non-incumbent all-cargo carriers United Parcel Service and Polar Air Cargo gained new operational flexibility, which create valuable new opportunities to transport cargo to destinations beyond Japan. In four years, another U.S. all-cargo carrier can enter the market.

The MOU allows, for the first time, extensive code-sharing between U.S. carriers, U.S. and Japanese carriers, and U.S. and third-country carriers on services between the United States and Japan and beyond Japan. Other new services also are being permitted, including an increase in charters from 400 to 600 flights per year in two years and eventually rising to 800 flights. Distribution and pricing provisions of the MOU promote competition, and Japan has guaranteed U.S. carriers fair and equal opportunity to contract with wholesalers and travel agents and to set up enterprises to market their services directly to consumers.

While the agreement is liberalizing U.S.- Japan air services, additional benefits will take effect automatically in four years if a fully liberalized agreement is not in place by then. The Administration is committed to seek further liberalization in line with its global policy of "open skies" to minimize government interference in civil aviation and to provide full and equal opportunities for U.S. and foreign passenger and cargo carriers to compete in each other's market.

The United States estimates that, as a result of the agreement, U.S. passengers will enjoy gains of $1.2 billion over four years, measured in terms of additional service in a more competitive market. U.S. carriers are expected to earn additional revenue of just over $4 billion over four years, due in part to an anticipated increase in U.S.-carrier market share. In addition, U.S. exports of aviation services should have a net increase of almost $4 billion over the next four years.

Implementation of the MOU proceeded smoothly over the balance of 1998. Although a recession in Japan and much of Asia slowed an anticipated expansion of U.S. air traffic, due to the new agreement, U.S. carriers took full advantage of their new rights. Several U.S. cities obtained their first non-stop air service to Japan and frequencies on existing routes increased. A Japanese carrier formed a codeshare alliance with a U.S. carrier for the first time and two U.S. carriers began codesharing with each other on international service to and beyond Japan. More codeshare arrangements are possible in the future.. Disagreement over the interpretation of third-country codeshare rights in the MOU temporarily delayed

Japan's consideration of the codeshare application between a U.S. carrier and a third-country carrier to serve Japan, but the issue was eventually resolved favorably.

Narita Airport Issue

In 1994, U.S. carriers serving Tokyo's Narita Airport, with U.S. and Japanese Government involvement, agreed with the Airport on a ten-year Master Plan for renovating the older Narita terminal used by most U.S. airlines. The rebuilding project was to be gradual in order to minimize disruption to our carriers. In the Spring of 1998, Narita Airport officials unexpectedly announced that they were seriously considering a major modification of the final phase of the Master Plan, which would have seriously affected the future commercial interests of a major U.S. carrier. Following several meetings involving officials of the U.S. carrier, Narita Airport Authority, the United States and Japan, the Airport and the U.S. carrier, in March 1999, reached a fundamental understanding over modifying the final phase of the 1994 Master Plan. The United States welcomes the understanding and continues to monitor the implementation of the Master Plan to support the commercial interests of U.S. carriers.

Direct Marketing

In recent years direct marketing (a.k.a. direct selling) has become an increasingly popular way to sell housewares, personal care products, and health supplements in Japan at a discount compared to prices in local retail stores and has proved to be an effective means of distributing U.S. exports throughout Japan. It also is a way by which local distributors, who are largely part-time independent workers, such as housewives and older people, can supplement their family incomes. Direct selling in Japan was estimated to account for $30.2 billion in sales and employed 2.5 million distributors in 1997. MITI regulates these activities through enforcement of consumer protection laws that prohibit fraudulent or misleading sales practices.

In 1998, a Japanese consumer organization alleged that a leading U.S. direct selling company in Japan was engaged in questionable sales practices based on complaints it had received. However, the number of complaints was very few, the allegations largely unsubstantiated and, in any case, unwarranted since the company in question was complying fully with Japanese laws regulating direct selling activities. The United States expressed concern to Japan regarding this issue, after which harassment of the U.S. firm subsided. Nonetheless, the firm suffered sales losses as a result of the allegations and was forced to reorganize its local sales force at considerable expense. The U.S. Government is continuing to consult with industry and to monitor that situation closely.

Electrical Utilities

The cost of electric power in Japan is the highest in the industrialized world. The United States believes that one of the most effective ways for Japan to reduce costs in this sector would be the introduction of genuine competition into non-fuel procurement. Non-fuel procurement is presently valued at approximately $25 billion annually, with imports representing only about 5 percent of this total, considerably lower than the foreign share of other developed markets. Some Japanese utilities are making noteworthy progress in this area, but with others lagging behind, the United States continues to urge the utilities to internationalize their procurement.

Among the barriers faced by foreign firms are standards and specifications used by Japanese utility companies that often discriminate against or otherwise disproportionately affect foreign suppliers. Particular problems in this regard are the use of narrow, dimension-based technical standards rather than

performance-based technical standards; the lack of harmonization with international standards; and requirements that suppliers provide detailed information on standards and specifications for spare parts originating from outside sources. For example, although the Japanese Government has taken gradual steps toward performance-based standards since March 1997, the utilities' purchasing practices have remained unchanged because the utilities' procurement manuals have not been revised to reflect the new performance-

based standards.

The United States also seeks greater transparency and fairness in the procurement process. Expensive and time-consuming procedures are generally required for a company to be added to the list of designated suppliers for a particular utility company, including requests that suppliers submit detailed information on proprietary manufacturing processes. Equal access to procurement information also is a problem, and foreign firms often do not learn about procurements until after they have been awarded. Moreover, U.S. firms have expressed concerns that the periods allocated for bid submission and product delivery are too short and that, while many utilities make procurement information available in English, bid documents and related technical documents must be submitted exclusively in Japanese.

In some cases, Japanese utilities have taken concrete steps to streamline and simplify their procurement standards and adopt international standards. In addition, Japanese utilities have taken a more active role in developing relations with potential U.S. suppliers. The U.S. Power Equipment/Services Executive Mission (May 18-22, 1998), organized by the Commerce Department, received strong support from the twelve Japanese electric power utilities and provided the 23 U.S. company participants an opportunity to meet all twelve utilities and to make presentations on their products and services. Through the New Orleans Association (NOA) -- a forum designed to help U.S. suppliers of power generation, transmission and distribution equipment gain access to the Japanese power equipment market -- utilities have made strong efforts to explain their procurement procedures, learn about U.S. products, and establish business relationships with U.S. suppliers. The number of utilities that publish procurement information in English on their Internet home pages has been increasing and some companies have sent their buyers to U.S. trade shows. Moreover, some utilities have assisted U.S. firms in developing relations with distributors and service companies to facilitate the procurement and after-sales service process. Although representing only a small part of non-fuel procurement, utilities in Japan are also making notable progress in expanding foreign procurement of telecommunications products.

Flat Glass

Flat glass is a classic example of Japan's resistance to open markets. Despite their extensive experience and success in other countries and many years of active efforts in Japan, U.S. flat glass manufacturers have failed to break the stranglehold of Japan's flat glass oligopoly.

Valued at $4.5 billion in 1998, Japan's flat glass market is the world's second largest. Three domestic producers continue to dominate the market they have shared among themselves for more than 30 years. They exert tight control of distribution channels in many ways, including majority ownership, equity and financing ties, employee exchanges, and purchasing quotas. At the same time, they change prices, capacity, and product mix in virtual lockstep, thereby maintaining constant market shares. Asahi Flat Glass controls close to half of the market, Nippon Sheet roughly a third, and Central Glass about a fifth.

In January 1995, the United States and Japan concluded an agreement to open Japan's flat glass market to foreign suppliers. Pursuant to that agreement, Japanese glass distributors publicly stated that they would diversify supply sources to include competitive foreign glass suppliers, and that they would not discriminate among suppliers based on capital affiliation. Japanese glassmakers expressed support for

diversifying their *de facto* exclusive distribution networks. The Government of Japan also committed itself to remove discrimination in public works projects, and to promote the use of insulated and safety glass, where American companies have superior products. An annual survey is undertaken under the agreement to assess the openness of the distribution system.

The agreement has helped American firms to a limited extent. For example, it induced Japan to feature American glass in a number of high-profile public construction projects. In addition, it obligated Japan to adopt new energy conservation standards that will raise the demand for insulated glass. U.S. exports of this type of glass have increased significantly in 1998, albeit from a low base.

But the basic problem remains the same: U.S. glass manufacturers still have a minuscule share of the Japanese flat glass market, despite the fact that Japanese companies and distributors readily acknowledge the high quality and lower cost of American glass. U.S. firms report that their market share of construction- related flat glass has not increased over the last four years. Japan's Ministry of International Trade and Industry (MITI) has claimed that the United States is the market leader in imported glass, with a steady increase in market share during the same period. Their data, however, include automotive and other specialty glass imports, such as glass for liquid crystal display (LCD). U.S. industry points out that these products are irrelevant to the problems that gave rise to the agreement, because they are sold through completely separate distribution systems. MITI also counts imports from Japanese affiliates in U.S. market share estimates.

In total, foreign companies supply about seven percent of Japan's flat glass market; in most other major industrial markets, including the United States and the EU, the market share of foreign-owned companies (via imports and in-country production) is more than five times the level in Japan. Foreign subsidiaries of Japanese manufacturers also supply Japan's flat glass market. Because these firms have privileged access to their parent companies' distribution systems, their sales to Japan reveal little about the market's openness.

The domination by domestic flat glass manufacturers of local distributors shows no sign of abating. Indeed, there is evidence that it is increasing. Manufacturers are using Japan's recession and the resulting tight credit market to tighten their financial hold on the most important glass distributors. In some cases, they have assigned their own employees to run the distributorships. Moreover, certain Japanese manufacturers appear to be using aggressive pricing strategies to dissuade distributors from handling foreign glass.

Concerns about inadequate progress prompted the United States in the Spring of 1998 to seek an update of the 1993 JFTC survey of the flat glass industry and Japanese Government participation in an initiative to strengthen the Antimonopoly Law compliance manuals and programs of the Japanese flat glass manufacturers and distributors. Japan accepted the first proposal. The survey is underway, with completion expected by Spring 1999. Japan rejected the compliance initiative, prompting the United States to provide the JFTC and MITI with an in-depth analysis of the flaws in the Antimonopoly Law compliance manuals and programs of two Japanese flat glass manufacturers. In response, Japan indicated that the JFTC's upcoming survey of the sector would examine this issue.

In January 1999, the United States presented MITI with new proposals to engage it more directly in efforts to guarantee the agreement's success. Its proposals included MITI consultations with distributors; a MITI consultation desk to deal with market access complaints; a joint examination of equity links between manufacturers and distributors; and industry/government talks to facilitate dialogue on Japan's flat glass market. The United States and Japan continue to discuss these ideas.

Paper and Paper Products

In April 1992, the United States and Japan signed "Measures to Increase Market Access for Paper Products," a five-year agreement aimed at substantially increasing access to Japan's market for paper products. In the agreement, the Japanese Government committed itself to encourage companies to increase

imports of competitive foreign paper products; introduce transparent corporate procurement guidelines; encourage key end-user segments of the Japanese market to use foreign paper; and introduce Antimonopoly Law compliance programs. The Japanese Government also promised to provide assistance to foreign paper suppliers in the form of market information and low-interest loans. The agreement expired in April 1997.

To date, there has been no meaningful increase in Japanese imports of paper and paperboard products and the level of import penetration for paper and paperboard products in Japan remains the smallest in the industrialized world. Despite continued U.S. efforts to press the Japanese Government to open the paper market, including the citation of market access problems in Japan in the sector as a practice that may warrant future identification as a "priority" foreign country practice under Super 301 provisions of U.S. trade law, the Japanese Government has insisted that it does not maintain barriers to market access in this sector. A key problem, according to U.S. producers, is weak enforcement of Japan's Antimonopoly Law and the existence of exclusionary business practices. U.S. negotiators have discussed competition issues affecting this sector under the Enhanced Initiative's Structural Issues Working Group, which takes up Antimonopoly Law enforcement and competition policy.

The United States has also sought Japan's full participation in the APEC forest products sectoral liberalization initiative that envisages, among other things, the accelerated phase out of tariffs on paper and paperboard products in Japan. At the November 1998 APEC Leaders' Meeting, Japan refused to participate in cutting tariffs in this sector, but committed with other APEC nations to negotiate tariff reductions (in this and seven other sectors) in the WTO. The United States will press Japan to play a constructive role in concluding agreement at the WTO in 1999, with a view towards eliminating wood product tariffs in the 2002-2004 time frame.

Consumer Photographic Film and Paper

Foreign photographic film and paper manufacturers face a variety of obstacles that restrict access and sales of their products in Japan, the second largest film market in the world. These obstacles have prevented foreign firms from gaining access to the main distribution channels for film.

After an extensive investigation, initiated in response to a petition by Eastman Kodak Co. (Kodak), the USTR in June 1996 made a determination of unreasonable practices by the Japanese Government with respect to the sale and distribution of consumer photographic materials in Japan. Its investigation showed that the Japanese Government built, supported, and tolerated a market structure that impedes U.S. exports of consumer photographic materials to Japan, and in which restrictive business practices occur that also obstruct exports of these products to Japan.

To address these concerns, the Administration initiated dispute settlement procedures against Japan in the World Trade Organization (WTO), alleging that Japanese Government measures were inconsistent with the General Agreement on Tariffs and Trade (GATT). The European Union and Mexico joined the United States as third parties to the case.

The WTO Panel on film issued its final report on January 30, 1998, and failed to find Japan in violation of its GATT obligations. The United States expressed serious disappointment with the findings, stating that the interim report sidestepped the core issues raised by the United States, particularly the combined effects of the numerous measures Japan imposed to protect its market.

On February 3, 1998, the Administration established an interagency monitoring and enforcement committee, co-chaired by USTR and the Department of Commerce, to review implementation of formal representations made by the Japanese Government to the WTO about efforts to ensure Japan's openness to imports of photographic film and paper. The monitoring and enforcement committee surveyed the Japanese photographic film and paper market and assessed information and data obtained from U.S. and other foreign film manufacturers and the Japanese Government. The committee issued its first semi-annual report in August 1998.

The report outlined distinctly different trends in the availability of foreign film in the two main segments of the market. Availability has declined slightly in the traditional photo-specialty stores, which comprise nearly half of the Japanese film market by sales volume. Competition in this market segment continues to be less robust. However, the report found that the availability of foreign film has doubled over the last three years in "non-traditional" outlets, such as supermarkets, department and convenience stores, and other non photo-specialty stores. These stores represent a market segment that is relatively more open and where competition is more vigorous than in the rest of the photographic materials market.

The report attributed the improved access in non-traditional stores to several factors, such as the heightened focus on this issue over the past few years as a result of U.S. trade actions, nascent structural changes in Japan's distribution system, and initial steps by the Japanese Government to address exclusionary business practices in the film sector. Continued and active efforts by Kodak and other foreign film manufacturers to market their products in Japan also have played a role. However, the continued use by Fuji Film Co. (Fuji) and its primary wholesalers of unreasonable business practices that exclude its competitors has contributed to the lack of improvement in access to the traditional photo-specialty stores, which remain a key film distribution channel.

The report also cited specific areas where additional action by the Ministry of International Trade and Industry (MITI) and the Japan Fair Trade Commission (JFTC) is warranted. These include steps to improve dissemination of MITI and JFTC guidelines on business and distribution practices, ensure that new measures regulating large stores are not allowed unreasonably to restrict competition or to favor small and medium-sized stores, and intensify JFTC monitoring of Fuji activities, especially tying arrangements and retaliatory threats by Fuji against Japanese retailers that promote foreign brands or photographic film or paper.

On September 4, 1998, the JFTC issued an official "warning" to the Photosensitive Material Industry Association, the Japanese film industry's primary industry association, that the Association's information exchange activities may constitute a violation of the Antimonopoly Law. The JFTC found that the association's collection, analysis and dissemination of information among its membership regarding the value and volume of individual firms' production and shipment of photographic materials may have resulted in acts of restricting or constraining competition. The JFTC warned the association not to engage in such types of information collection and exchange in the future.

In preparation for its next semi-annual film monitoring report, the monitoring and enforcement committee continues closely to scrutinize foreign access to Japan's film market and the Japanese Government's efforts to open this market in accordance with its WTO representations. The committee will release its next semi-annual film monitoring report in the Spring of 1999.

Sea Transport and Freight

American carriers serving Japanese ports have encountered for many years a restrictive, inefficient and discriminatory system of port transportation services. Following extensive research and deliberation, the Federal Maritime Commission (FMC) determined in February 1997 that Japan maintained unfair shipping practices and proposed fines against Japanese ocean freight operators. The FMC delayed implementation of the fines after the U.S. and Japan reached an understanding in April 1997, under which the Japanese Government pledged to grant foreign carriers port transport licenses and, at the same time, to reform the prior consultation system, which allocates work on the waterfront and requires carriers to obtain approval for any change in their vessel operations.

Japan's failure to carry out these reforms by July 31, 1997 resulted in FMC implementation of the fines on September 4, 1997. The two governments reached an understanding in October 1997, which was recognized in an exchange of letters between Secretary of State Albright and Japanese Ambassador Saito. The understanding noted two agreements among the Japanese Government, foreign ship owners, Japanese ship owners and the Japanese Harbor Transport Association, in which they committed to improve the current prior consultation system, and to establish an alternative method to the current prior consultation system. The Ministry of Transport also agreed to approve foreign carriers' applications for harbor services licenses if those applications satisfied the requirements set out in the April understanding. The United States believes that these actions provide a solid foundation for reform of Japanese port practices. Sanctions were suspended on November 13, 1997. The United States continues to vigorously monitor the agreement to ensure its full implementation.

Significant deregulation of port transport services is still needed, particularly elimination of the supply-demand adjustment requirement and rules that underpin allocation of port transport work. The United States has asked that this deregulation be completed by December 1998. As of this writing, the Harbor Transport Subcommittee of the Ministry of Transport, which was tasked with preparing recommendations for deregulation, had published its interim report. The United States submitted formal comments on this report on January 22, 1999. While appreciative of the Ministry of Transport's solicitation of public comments on the interim report, the United States expressed strong concerns about the report's failure to promote real competition on the docks. Key issues of concern are the report's failure to address restrictive licensing requirements and to recommend the development of an improved/alternative prior consultation process. The United States will closely monitor the work of the Harbor Transport Subcommittee over the next few months, as it completes its task of putting together a list of recommendations for meaningful deregulation of Japan's ports.

Motorcycles

Japan maintains two restrictions on the use of large-class motorcycles that artificially limit the market for large-class motorcycles in Japan, adversely affecting U.S. exports. These restrictions, which are contained in the Road Traffic Law, include (1) the prohibition of tandem riding (i.e., carrying a passenger) on motorways and (2) the differential, lower speed limit applied to motorcycles. The United States has provided evidence to Japan demonstrating that these restrictions are unnecessary and likely to detract from highway safety.

On the tandem riding issue, research shows that motorways are safer than ordinary roads, and that passenger-carrying motorcycles have a much better safety record than single-rider motorcycles. Thus, because the current law requires motorcycles which passengers to travel on less-safe non-motorway roads, it increases accident risk. On the differential speed limit issue, a large volume of traffic research shows that accident risks are increased for vehicles traveling either faster or lower than the rest of the traffic stream.

Thus, by requiring motorcycles to observe a lower speed limit than automobiles, current law places them at greater risk of an accident.

In the 1960s, most motorcycles in Japan were small and now well-suited for carrying a passenger at motorway speeds. Today, touring motorcycles and other large-class motorcycles are designed and built to carry a passenger safety at motorway speeds. Repealing these two restrictions would improve, not reduce, highway safety in Japan and would contribute to a more open Japanese market.

Semiconductors

In August 1996, the United States and Japan announced a third arrangement on semiconductor trade. This arrangement, like the 1986 and 1991 semiconductor arrangements that preceded it, was negotiated to ensure U.S. access to the Japanese semiconductor market. The 1996 measures represent an innovative multi-dimensional approach to a sector in which market access is promoted not only through government-level discussion but also through concrete industry-level partnership. Under the current agreement, U.S. success in the Japanese market, and cooperation between the U.S. and Japanese semiconductor and microelectronic industries, have continued to increase.

The heart of the new agreement is an industry-to-industry accord which provides a continuation of the industry-level cooperative activities to expand market access in Japan that existed under the 1991 agreement, and an expansion of that cooperation to new areas. U.S. and Japanese semiconductor industries, as well as semiconductor industries of other economies committed to tariff-free trade in semiconductors, meet annually in the World Semiconductor Council (WSC). Included within the Council's scope are both a continuation of existing user-supplier cooperative activities (in the area of semiconductor technologies for telecommunications, automotive and emerging applications) and a range of new supplier-supplier cooperative activities (in such areas as standards, intellectual property, environmental and safety issues, and others). The United States and Japan were the founding members of the WSC; Korea and the European Union were invited to join in 1997, and Taiwan will participate starting in 1999.

Moreover, the measures, through a bilateral government statement, also established a multilateral Government Consultative Mechanism, essentially to oversee and interact with the Semiconductor Council. Governments whose industries have joined the Council participate in these annual consultations, at which members of the Council report on the Council’s activities and present Council recommendations on policy issues to the governments.

The measures also, through the bilateral government statement, established the "Global Governmental Forum" (GGF). Governments of all major semiconductor-producing nations and economies are invited to participate in this forum, which meets annually to discuss policy issues of interest to the semiconductor industry (e.g., trade and investment liberalization, environmental issues, worker health and safety, intellectual property protection, and other matters). The second annual GGF was held in Washington in January 1998, with the United States, Japan, the EU, Korea, and Chinese Taipei attending.

Finally, after the announcement of the new arrangement on semiconductors, the Semiconductor Industry Association (SIA) and the Electronics Industries Association of Japan (EIAJ) announced an industry-level agreement on anti-dumping, which reaffirmed the need to avoid injurious dumping through effective and expeditious antidumping measures consistent with the GATT / WTO Antidumping Agreement. Consistent with this agreement, individual semiconductor producing companies are continuing to collect and maintain

specified data on a voluntary basis, which can be produced in an antidumping investigation on an expedited basis.

The foreign share of the Japanese semiconductor market has continued its upward trend under the 1996 agreement. Foreign market share averaged 27.5 percent in 1996, and 33.3 percent in 1997, and reached 33.9 percent in the second quarter of 1998. This compares with a foreign market share of less than 15 percent when the 1991 agreement was negotiated. This progress has been made possible by the concerted efforts made by all parties, most notably the efforts U.S. semiconductor manufacturers have made to adapt their products to the needs of the Japanese market, and the efforts Japanese semiconductor users have made to open up their procurement practices. The Administration will continue to work closely with U.S. industry and the Japanese Government to ensure that the commitments made in the 1996 semiconductor agreement are fully and successfully implemented.

Steel

The global financial crisis and accompanying slowdowns in building and manufacturing have led to a catastrophic drop in demand for steel in depressed regions, particularly in Asia. This, combined with global overcapacity in the steel sector, a booming U.S. economy, favorable exchange rates, and desperate foreign sellers, has resulted in a massive surge in steel imports to the United States.

Japan is the single largest steel exporter to the United States. In 1998, steel imports from Japan increased 163 percent by volume over 1997. Japanese exports of hot-rolled carbon sheet steel to the United States rose 460 percent in the first eleven months of 1998.

In January 1999, the Administration outlined a steel action plan ("A Report to Congress on a Comprehensive Plan for Responding to the Increase in Steel Imports"). With respect to Japan in the report and in the subsequent statement, the Administration has raised the possibility of self-initiated remedial action under U.S. trade law if steel imports from Japan do not return to 1997 pre-crisis levels.

MITI has indicated that steel exports from Japan are already being significantly reduced in large part as a result of a preliminary finding in its anti-dumping case on hot-rolled steel from Japan on a voluntary basis. MITI and the Ministry of Finance have announced figures showing Japanese steel shipments of 367,000 metric tons for December 1998. This represents almost a 21 percent decline from their figure for November 1998 and a 15 percent decline from the figure for December 1997. However, the Administration has made it clear that further significant reductions are necessary to reach an aggregate pre-crisis level.

The Administration is vigorously enforcing U.S. anti-dumping laws and is considering options for further actions, while fairly determining the validity of steel dumping allegations. Any further actions by the United States would be consistent with WTO obligations. The President and all U.S. Government agencies engaged in the steel issue are committed to pursuing objective findings and maintaining and opening fair and free markets in a global economy.

U.S. steel producers have expressed concerns that Japanese steel companies may be engaging in anticompetitive practices. With respect to Japan's domestic market, it is alleged that Japan's five integrated producers discuss and coordinate output, pricing, and market allocation goals--with the knowledge of Japan's Ministry of International Trade and Industry. In addition, it is alleged that Japanese mills have entered into a series of arrangements with foreign counterparts to regulate bilateral steel trade. It is believed

that these arrangements, as well as tight control by major integrated producers over steel distribution channels in a manner which strongly discourages imports, explain the fact that the market shares of Japan's five large mills have remained absolutely stable over the last three decades. The Administration has expressed concerns about these allegations to Japanese officials and has urged them to vigorously and effectively deal with any such activities. The Administration will continue to actively review any evidence of anticompetitive activity or market access barriers in the steel sector.